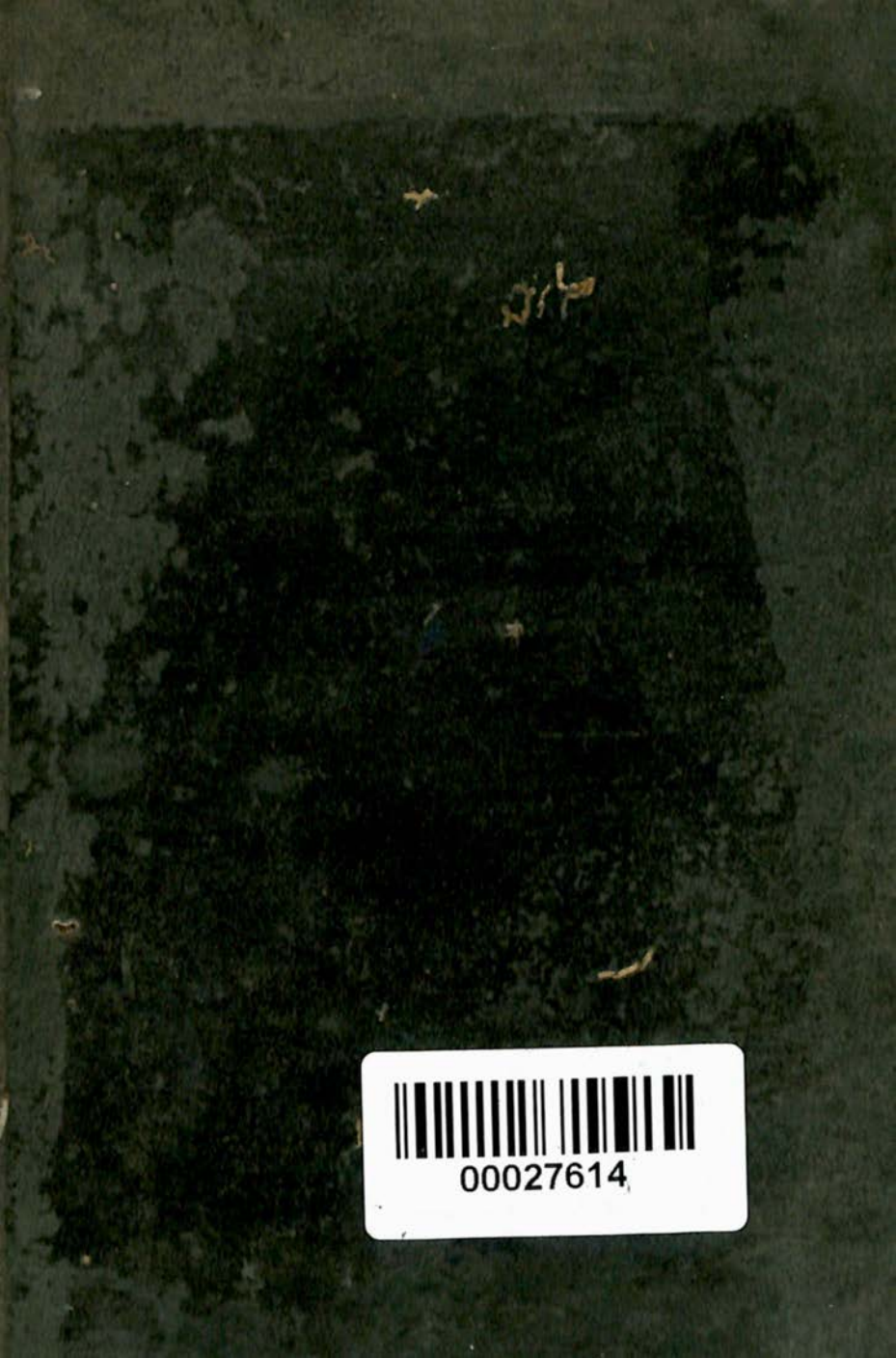
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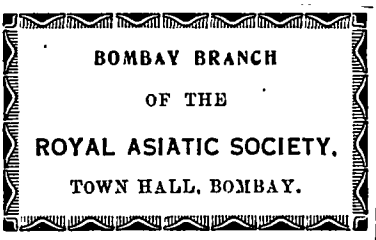

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A GRAMMAR

OF

POLITICAL ECONOMY

In One Volume, crown 8vo. cloth.

SOCIALISM:

ITS NATURE, ITS DANGERS, AND ITS REMEDIES CONSIDERED.

BY THE

REV. M. KAUFMANN, B.A.

CURATE OF CHARD.

Founded on the German Work 'Kapitalismus und Socialismus,' by Dr. A. E. F. SCHAEFFLE, Ex Minister of Commerce in Austria, and late Professor of Political Economy at the University of Vienna.

HENRY S. KING & CO., London.

A GRAMMAR

OF

POLITICAL ECONOMY

BY

MAJOR-GENERAL W. F. MARRIOTT, C.S.I.

LATE SECRETARY TO THE GOVERNMENT OF BOMBAY

27614

HENRY S. KING & CO.

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1874

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PREFACE.

IN PUBLISHING a new elementary treatise on Political Economy, some explanation of the supposed need for it, is due.

A thoughtful man may criticise justly what he could not originate; and may judge the conflicting arguments of those who are, severally, his superiors in general knowledge of the subject. In this sense, with unabated respect for the teaching of Adam Smith, Ricardo, Mill and others, I offer this Grammar as likely, in proportion to its scope, to give more concise and accurate guidance to the student, than the other elementary works with which I am acquainted. Some treatises are too hypothetical in arbitrary limitation of the problems which the facts present. Instances of this character are exhibited in the notes to Chapters IX. and XIII. on 'Value' and 'Rent' respectively. Others are too

ambiguous in the use of important terms. Examples of this are given in Chapter V. on 'Capital.' Some are so discursive that they want the scientific precision and brevity needful in a purely elementary work.

My aim is;—firstly, to restrict the treatise to the truly elementary considerations in each branch of the subject;—secondly, to adopt a perfectly precise and unambiguous use of terms, in the sense which most nearly agrees with common use;—thirdly, to offer reasonable proof of every proposition;—fourthly, to use the utmost brevity consistent with proof, so as to invite and facilitate the judgment of the student as well as of the critic.

Wherever I assert without formal proof, I mean to appeal to common experience or to the obvious application of previous conclusions, as affording sufficient proof. The facts are often too complicated and obscure for purely inductive proof; and the only practicable demonstration, in such cases, is by *à priori* reasoning, the conclusions of which are confirmed by prominent facts or by general experience.

Propositions precisely conceived and accurately

stated, may give useful direction, even though they be not wholly accepted; and, in the belief that this Grammar has, at least, that character of precision in conception and accuracy in statement, I offer it to the student of Political Economy.

W. F. M.

August 1874.

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A GRAMMAR

OF

POLITICAL ECONOMY.

CHAPTER I.

INTRODUCTION.

POLITICAL ECONOMY is not a very fit name for the science which it denotes, because of the wide difference between the literal and conventional meanings of the name. It was appropriate when used by Adam Smith, who regarded the science as 'a branch of the science of the statesman or legislator,' having for its object 'to provide a plentiful revenue or subsistence for the people, and to supply the State with a revenue sufficient for the public services.' But the scope of the science has subsequently undergone much change; and all now regard it as, in some sense, the science of the laws of production, exchange, and distribution of wealth. This conception, however, is limited in several ways. The physical laws affecting production are excluded, their operation being

CHAP. I. regarded as constant. Effective restraint by social law is supposed, to the exclusion of fraud and violence. Freedom from all merely forceful interference with production and exchange is presumed, excepting when specific kinds of such interference, as for instance, by the levy of taxes or duties, are treated of.

One eminent writer, Mr. MacLeod, offers as a perfectly accurate definition of the science, that it is 'the science of the laws which regulate the exchangeable relations of quantities.' This seems nearly equivalent to the definition suggested by Archbishop Whately, viz. 'the science of values.' But to this, Mill offers the valid objection that the consideration of value regards the *distribution* of wealth too exclusively of the *production* of it.[1] For instance, the suggested definition would exclude the Malthusian theory of the relative increase of population and food, from the province of political economy.

It is evident that the statement of the science as related to 'wealth,' anticipates exact definition of the name 'wealth'; but the word has a meaning sufficiently uniform to permit acceptance, at the outset, of the provisional definition, that political economy is the science of the laws of production, exchange, and distribution of wealth, with the limitations above stated.

In modern times, the extension of commerce of all kinds has drawn much attention to this science, whose problems underlie many widely interesting questions,

[1] *Principles of Political Economy*, Book II. chap. i. Second edition.

such as taxation, commercial laws, and the relations of rich and poor. The multiplication of means, especially those of a joint-stock character, for the profitable use of capital, has made it more than ever needful that the wealthier classes should understand the laws of production, and gives them an increased interest in the complicated and as yet unsettled discussion regarding state control of banking operations, the functions and utility of national banks, and currency laws. Above all, the influential fallacies regarding the relations of labour and capital, which are spread and received in good faith, although in ignorance, amongst the manual labourers throughout Europe, make it of the first importance that all who are likely to take an active part in politics and social questions, should apprehend truly the elements of politico-economical science. CHAP. I.

Purpose of the treatise.

The purpose of the present treatise is to exhibit as clearly as possible, the elementary laws and facts only; so to give true elementary ideas by which to understand the views of writers, speakers, and administrators in these matters; and by which each, according to his ability, may work out to sound conclusions the practical questions which he encounters.

CHAPTER II.

FUNDAMENTAL FACTS.

CHAP. II. THE primary facts which underlie all the phenomena of production and exchange of wealth, are as follows:

1. Food is an absolute necessity, and many other things are comparative necessities, for human life.

2. Human labour is necessary to produce the necessaries of life. (Although nature, in some instances, produces food and some other needful things, without human labour; yet, irrespectively of the consideration that there must be some labour to collect the things and make them available to man, the extent of such spontaneous supply is too insignificant to modify, for practical scientific purposes, the general rule that human labour is a necessary element in the production of necessaries of life.)

3. Under ordinary circumstances, men's labour can produce more than the labourers necessarily consume during the process of production. In other words, the necessaries of life can ordinarily be made to reproduce themselves with some excess. The labour of a few suffices to provide the necessaries of life for many; and

part of man's labour is available to supply other things than the necessaries of life. CHAP. II.

4. Those who do not produce necessaries of life must procure them from others; and can do so only by offering other desired things in exchange. Hence the necessity for constant exchange of produce.

5. Experience shows that the additional means of enjoyment, beyond mere necessaries of life, obtainable by labour, are practically unlimited; and that, consequently, there is a constant general desire to accumulate any things which are likely to afford those means either directly or by exchange. This desire induces the greater part of mankind to labour greatly in excess of what would be needful for bare existence.

6. With insignificant exceptions, there is an interval of time between the exertion of human labour and the production thereby of necessaries of life, which makes it an absolute necessity that there be a stock of previously acquired necessaries of life to support the labourers during the process of production.

7. Man's labour cannot obtain the necessaries of life without the aid of the natural agents which comprise the productive powers of nature; and this holds good of all material production.

8. Everyone is sustained by previously acquired necessaries of life; and the need for sustenance compels all to labour, excepting those who possess stored necessaries or other produce which they can exchange for

CHAP II. necessaries, or who have in some way acquired a right to such things stored by others.

9. Notwithstanding the exceptions made by the operation of other motives than the wish or need to accumulate desirable things, the desire to obtain the utmost in exchange is a general law, to which each man's consciousness and experience bears witness, and without which the phenomena of production and exchange are inexplicable.

10. In all exchanges there is a mutual need and mutual demand. If a man exchange food for clothing, he may be described indifferently as selling the food or buying the clothing. Each of the exchangers is both buyer and seller. Each is moved by need; the one by need of clothing, the other by need of food.

11. The quantities obtainable in exchange are seen to depend upon the comparative need for the things exchanged.

12. In the case supposed in Proposition 10, the only measure of comparative need is the quantity of food that the first is willing to give and the other to accept for a certain quantity of clothing, or *vice versâ*; or the quantity of food which the last demands in exchange, and the first is willing to give, in exchange for a certain quantity of clothing, or *vice versâ*. Need, therefore, is measured by and is correlative with demand.

13. These two facts, that each desires to obtain the utmost in exchange, and that the quantity obtainable

depends upon relative need or demand, are attended by a further consequence, which, although it be not so immediately obvious, is unquestioned by any who observe the facts, to wit, that the desire to buy and the desire to sell (which are convertible terms, because the man who buys anything, sells the things he gives in exchange) beget competition amongst buyers and sellers respectively; and the competition tends to increase the quantity of things which each offers in exchange. CHAP. II.

14. A further consequence confirmed by experience, is that an increase of the supply of anything tends to increase the competition of the sellers of it, and consequently, to increase the quantity which they offer in exchange for other things. And a decrease of the supply of anything tends to increase the competition of the buyers of it, and consequently, to increase the quantity of other things which they offer in exchange for it.

To avoid a confusing repetition of the words 'quantity of things offered in exchange,' we may conveniently at once adopt the technical term 'value.' There is a perfectly uniform acceptance of this word as signifying value in exchange. The quantity of any other things obtainable for any one thing, constitute the value of that one thing.

15. A further consequence of Propositions 13 and 14 above, confirmed by experience, is that an increase of the value of anything tends to an increase of the supply of it. The reason is obvious; because the greater the

CHAP. II. value, the more profitable is the sale of it, and therefore the greater is the inducement to produce the profitable thing.

16. Similarly, decrease of the value of a thing tends to decrease of the supply of it.

17. Again, the increase of the value of a thing means that those who demand it must give more of other things for it; and as men do not willingly give more in exchange than they are used to give, the increase of value tends to unwillingness to buy; and hence the increase of the value of a thing tends to decrease of the demand for it.

18. Similarly, decrease of the value of a thing tends to increase of the demand for it.

19. The foregoing statements of tendencies are mutually counter, as may be seen by the following comparison.

		Prop.
Increase of demand (competition of buyers)	increases value .	13
Increase of value	diminishes demand .	17
Increase of supply	diminishes value .	14
Diminution of value	diminishes supply.	16
Increase of value	increases supply .	15
Increase of supply	diminishes value .	14

20. Propositions 2, 6, and 7 above, exhibit human labour, natural agents, and a stock of previously acquired necessaries of life, as the three indispensable elements of production. Nearly all labour, moreover, is aided by machinery (using machinery in a wide sense, including all mechanical aids to labour). So that whilst the indispensable elements of production are the

three above named; the ordinary means of production are four-fold; viz., labour, natural agents, a stock of necessaries of life, and machinery. CHAP. II.

In the foregoing propositions we have used the term 'necessaries of life.' Food, and, in some countries clothing and shelter, are the only absolute necessaries of life. Other necessities are relative. But at any given time there are certain things which are necessary for the support of each kind of labour, in the practical sense that the labourers of that class, in their then present circumstances, will not work without them. The standard of such needs varies in different employments, in different countries, in different generations. What is, in this sense, necessary at one time and in one class, may be a comparative luxury at another time or in another class. It is thus evident that there are many things which cannot be assigned exclusively to the class of 'necessaries' or of 'non-necessaries;' yet the broad distinction remains that the whole community is sustained by means of necessaries of life either produced directly, or obtained by things given in exchange.

CHAPTER III.

WEALTH.

CHAP. III. Definition of wealth.

IT was noted in the introductory chapter that the conception of the science of political economy, as of the law of production, exchange, and distribution of wealth, anticipates an exact definition of wealth.

It is needful to have a precise conception and corresponding definition of wealth, and we need not go beyond the ordinary conception of it in common speech. An exceptionally wealthy man means one who has abundant means of procuring, without labour, whatever he needs. A single man's wealth is estimated by the exchange value of his possessions. An exceptionally wealthy nation means one that can produce more largely than others in excess of the mere necessities of existence; a nation therefore of which an unusually large portion is freed, more or less completely, from the necessity of labour to provide for their inevitable needs. (We say, '*inevitable* needs,' because those who are relieved from absolute necessity to labour, are not therefore devoid of other needs or desires, which they may supply by labour.) It is not the use or enjoyment of things by

their possessors which gives them the character of wealth. The conception of beautiful buildings or pictures as part of a man's wealth, depends upon associating possession with the possibility of selling them, not with the delight which they give to their owners. In this last respect they are conceived as delights procured by wealth, not as wealth itself. The most costly sepulchral monuments would not ordinarily be regarded as part of the wealth of the family to which they belong; because there is no possibility of selling them. CHAP. III.

The accurate definition of the common conception of wealth seems to be that it is *whatever enables, or can enable persons or communities to be in any degree independent of their own labour for the supply of their needs.* Many a single person is so wealthy as to be wholly independent of his own labour for the supply of his needs; whilst no large community can be wholly so. But the larger the number which out of any community can possibly be spared, more or less completely, from the work of production, the wealthier must that community be; not of course the wealthier *will* it be, but the wealthier it must have already become.

Operation of wealth.

Seeing thus the nature of wealth, we shall understand its operation. Wealth being whatever makes its possessor in any degree independent of his own labour for the supply of his needs; its force must consist, as we see that it does, in diminishing the necessity for labour to its possessor, or in commanding the labour, or

CHAP. III. produce of labour, of others. And as this force operates to procure the production of whatever its possessors desire, it must operate by directing the labour; which can only be, as observation shows, by directing the expenditure of the necessaries of life which support labour.

CHAPTER IV.

MONEY.

IT will facilitate the further development of the science if the nature and principal characters of money be now shown.

The nature of money.

Common observation shows money to be *a measure of exchange value, and a means of exchange.* As money it has evidently no other function. A gold or silver piece has other characters and function as a piece of metal, useful for many purposes besides money; but the use of paper money shows that this independent value of the thing used as money, is not absolutely essential to the nature of money as a measure of value, and as a means of exchange.

Nevertheless we see that gold and silver have become the money of nearly the whole intertrading world; whilst the use of paper money is restricted within the circles of the several governments which regulate it, to the almost entire exclusion of any international use of paper money. We have to consider the explanation of these facts.

The fundamental social necessity of barter, *i.e.* of

CHAP. IV. buying and selling by exchange of goods, is simple and unquestionable, and is assumed in Chap. ii. Prop. 4, as a fundamental fact. Out of this necessity have arisen two other needs, viz. a common measure of value and a common medium of exchange.

A very little reflection will show the nature of, and necessity for, a common medium of exchange. Without it barter would often be impracticable. If a carpenter wanting a coat, could offer nothing in exchange except his own labour, or the immediate product of his own labour, exchange with the tailor would be impracticable if the tailor had no need of the carpenter's services. Consequently, anything which every one desires to have at any time and in any quantity, must tend to become a medium of exchange between persons who have not mutual and equal need of the immediate products of each other's labour.

The other need of a common measure of value will also be easily perceived. If the carpenter pays the tailor by something other than the produce of his own labour, he needs the means of comparing the value of that 'something other' with his own labour; and the tailor who accepts it in exchange for a coat, equally needs the means of comparing its value with the material and labour expended by him in making the coat. The medium of exchange itself necessarily becomes the common measure and expression of the value.

Thus, in primitive pastoral communities, cattle might

naturally become a common medium of exchange, and consequently a common measure of value; and the etymology of the word 'pecunia' affords evidence that this was so in fact. Thus also it will be understood how the principal metals, because of their utility for the manufacture of tools and weapons, and of the general desire for some of them for ornamental purposes, might become, as they have in fact become, media of exchange and measures of value. CHAP. I

It is easy to perceive how anything for which there is a comparatively unlimited demand irrespectively of its use as money, might become money. The circumstance which now obscures the nature of money is, that the gold and silver used as money seem not to have a correspondingly universal utility irrespectively of its use as money; so that it appears to some persons as if the force of gold as money were something mysterious, or the traditional acceptance of it as a purchasing power irrational.

Let us first note what are the obvious characters which make anything convenient as money. It must be limited in quantity, either artificially as in the case of paper money, or by natural scarcity, as in the case of gold and silver. If there were no artificial restriction of the quantity of paper money, it would evidently become as valueless as any unauthorised paper money would be at present. If gold were as plentiful as iron, and were coined with as little restriction as at present, the quantity

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of coin which would measure the ordinary transactions of the market would be so inconveniently large, that some scarcer thing would inevitably be used as money. We see in fact, that, in Europe, silver has been substituted for copper or brass, and again gold for silver, for more convenient measure of higher values. The same process is going on in the East at present.

Moreover, for full convenience as money, the restriction of quantity must not be absolute; else, as exchange transactions increase (and we see that they increase continually), there would be no means of increasing the quantity of money. On the other hand, the means of multiplying the money must be costly; otherwise the desire of every one to possess as much as possible, would multiply the quantity inconveniently.

There must also be either a free traditional consent to use the thing as money, as is the case with gold and silver, or a legally enforced consent, as in the case of paper money.

'he essential conditions of ioney.

These two conditions of conveniently limited quantity and general consent, are the only absolutely essential conditions of money.

'he needful qualities of noney.

There are, however, other very needful qualities, the presence of which helps to induce the general consent. Money which cannot be replaced excepting at great cost, must for convenience be of an indestructible character. Its genuineness, also, must be easily ascertainable; and it must be capable of receiving permanent

impressions to certify its quantity and quality. It is thus evident why jewels, although in practically unlimited demand and scarce and indestructible, are unsuited for money; because, amongst other reasons, of the difficulty of ascertaining and certifying their quality. Beside other obstacles to the international use of paper money which will appear hereafter, the necessity for a legally enforced restriction of quantity, makes international paper money at present impracticable. CHAP. IV.

Gold and silver possess, more perfectly than anything else, all the above stated convenient qualities. Simple barter, without any reference to a common measure or medium of exchange, in the present complicated transactions of trade, is more than an inconvenience; it is practically an impossibility. So that some common measure and medium of exchange is a necessity; and the traditional consent of the intertrading world to use gold and silver for the purpose, is based on the simple ground of superior convenience for the purpose.

The character of the purchasing power of money.

Money, as such, is not desired for its own sake, but for the sake of its power of purchasing other things. The great mass of things seeking exchange are things produced by labour, which labour is supported by necessaries of life. The power of purchasing other things, is a command of labour's produce, which can be only by command of the necessaries of life which support labour If a man give a thousand pounds for a jewel, it is true that the seller of the jewel might give that money for a

CHAP. IV. picture, and, so far, there has been no purchase of necessaries of life; but still, let the stages of exchange of that money be ever so numerous, the exchange is at last for necessaries of life to support, it may be, jewellers and painters, or the producers of any other things of which the money effected the exchange. So that the purchasing power of money is equivalent to, and conceivably measurable by, its command of the necessaries of life which support labour.

A future chapter will show what regulates the purchasing power of money, *i.e.* what determines the quantity of money given in exchange for a thing, or the quantity of money which, as a medium of exchange of other things, represents the value of those things. It suffices at present to note the fact that the money possessed by each person represents some portion of all the things obtainable by money, or some portion of the whole stock of things seeking exchange by means of money and nothing else.

To resume.

1. The nature of money is a common measure of value, and a common medium of exchange.
2. The absolutely essential conditions of anything serving the purpose of money, are conveniently restricted quantity and general consent to use it.
3. The needful qualities are, durability, capability of verification and of receiving impressions to certify quantity and quality.

4. The purchasing power of money is equivalent to its command of the necessaries of life which support labour. CHAP. IV

5. Money represents things seeking exchange by means of money and nothing else.

CHAPTER V.

CAPITAL.

CHAP. V. WE find the term 'capital' in constant use amongst all persons concerned in using money or labour to purposes of profit. It is of very ancient use. MacLeod, in his 'Dictionary of Political Economy,' gives instances of the use of the equivalent term, 'to kephalaion,' by Plato and other ancient writers, as signifying the capital sum or principal sum of a loan, as distinguished from the interest of it. In England the term 'principal' is now generally used for this purpose; and 'capital' is used to designate that which, in some sense, supports labour, or puts labour in use and directs its use.

Definition of capital.

'Capital' is a term in constant use, also, by scientific writers. The meaning of the term is too nearly fixed by common use to allow of any arbitrary definition; and yet there is no agreement amongst scientific writers as to the formal definition of it; as may be seen from the various definitions in the appendix to this chapter. But there is an almost unanimous consent to regard capital as an indispensable means of production distinct from labour and land, or other natural agents; and it

will hardly be disputed that the fundamental idea of capital, in its present use, is of that which will sustain labour during the process of production. Labourers cannot produce without something to live upon whilst producing; and this means of support whilst producing, seems to be the fundamental idea of capital. CHAP. V.

We must consider, in the first place, what is the common-professional use of the term, both because of the great utility of preserving perfect consent, so far as consistent with scientific precision, in the common and scientific uses of any name; and because it offers an antecedent likelihood of indicating the classification which is practically most useful.

The experience of all familiar with the language of those professionally engaged in trade and money dealing, will, we believe, affirm that, in common professional speech, and when used in a general sense, 'capital' means that of which money is the equivalent. It is not by any means the same as money, but the equivalent; either money, or that which money is needed to procure; or that which, if need be, will procure money; *i.e.* it is whatever is generally available, either in its nature or by ready exchangeability, to sustain labour. (Chapter iv. Prop. 4.)

We do not mean that common use is perfectly consistent. It is much otherwise. The term 'capital' is often applied to anything which has the characters of a means of production and a part of wealth; although it

CHAP. V. be not such as can support labour either directly or by exchange. But that this is really a figurative use of the term, seems plain from the restricted signification when it is used generally. A general statement regarding temporary abundance or deficiency of capital, would never be supposed, by professional men, to include land, labour, or machinery, but only that which puts these in use; viz., money, or whatever is readily exchangeable for money, or, in more direct substantial fact, the things to support labour which money commands, and whatever is readily exchangeable for those things.

Moreover, in perfect accordance to the exclusion of machinery, land, and labour from the term 'capital,' when this is used in a general sense, is the use of the technical term 'fixed capital,' which, by a very general consent, is applied to machinery for productive purposes (using machinery in the widest sense, such as includes for instance needful buildings and roads, and generally every other permanent means, other than labour and natural agents, subserving production). Of course the capital which supports labour in producing machinery, is in fact as completely consumed as in any other production; but because the thing produced has so far the character of the capital expended, as that it aids labour in production, it is, by a reasonable figure, termed 'fixed capital.' The means so named must be comparatively permanent; because otherwise the capital would be

Definition of fixed capital.

simply consumed, like raw material, in the process of production; and would not be in any sense 'fixed.' The machinery must also, of course, subserve production; because otherwise it would want altogether the nature of capital as an aid to production.[1] CHAP. V.

Sometimes the names 'circulating capital' or 'floating capital,' are used in contradistinction to 'fixed capital;' and this is evidence of the need for the distinction which is constantly assumed in the frequent use of the simple term 'capital,' to represent all the things which are generally available to support labour.

The definition really implied in the common professional use of the term 'capital' seems, therefore, to be that it is *whatever can support labour, or can be readily exchanged for what will do so.*

It will appear also that this is a very convenient classification. We have shown (Chap. ii. Prop. 20) that labour, natural agents, and a stock of necessaries of life, are the indispensable elements of all production; whilst machinery is only an ordinary additional means. The force of natural agents may be regarded as constant. Labour is not ordinarily consumed by use. Machinery also is comparatively unconsumed by use. The element

[1] There is also another important sense in which the fitness of the term 'fixed capital' may be regarded. Capital which can sustain labour can be made to reproduce itself quickly. For instance, in tillage of the ground, the capital expended more than reproduces itself in one season. But the capital spent in making a road or extensive machinery, only gradually reproduces itself in a comparatively long period by the aid it gives to labour; and in this sense may be said to be more 'fixed.'

CHAP. V. which is actually consumed is the stock of necessaries which support labour. The sufficiency of this stock is all-important. It is constantly consumed and reproduced. A large portion of labour must always be employed in reproducing this stock; otherwise the race of man would perish, let the production of other things be ever so abundant. The need, therefore, for preserving the distinction of this element is manifest. It is presumably needful for scientific purposes, to distinguish the absolutely indispensable elements of production from mere aids to production. It is obviously needful, both scientifically and professionally, to distinguish, by separate classification, those things which form the specially destructible and the specially fluctuating element in the means of production; because it follows, as common experience shows, that, on the temporary abundance or deficiency of this element, depend the fluctuations of commercial prosperity and difficulty.

Looking at the several formal definitions of capital offered by various writers, as quoted in the note appended to this chapter, it will be seen that they are inconsistent with each other, and inconsistent with common professional use. The only conception common to all the definitions is, that capital is a means of production; and all but one imply, in accordance to common use, that capital is a means distinct from labour and natural agents. It must be admitted that they all imply the inclusion of 'fixed capital' under the

term 'capital'; but against this concurrence are the objections of common professional use and of convenience above shown. As an instance of the force of these objections, we would refer to the able writings of Mr. James Wilson. To the question, 'What really constitutes capital?' he replies: 'Capital consists of all improvements in the natural elements of production; of all implements which facilitate production; and of all commodities which, though produced for consumption, yet the value of which will be replaced to the producers from the incomes of those who consume them. Thus permanent improvements on land, by which larger crops are raised by the same labour; improvements in water courses, rivers, or docks; the construction of canals, roads, or railways, which facilitate intercourse and the exchange of commodities; buildings, ships, machines, cattle; all implements of reproduction and commodities of every description, such as cloth, wheat, sugar, gold, silver, iron, tea, which are produced for the purpose of sale, the price of which is to be replaced from the income of the consumers, while the profit only is to be consumed by the producers, constitute the capital of a nation.'[1] Having so defined capital, he proceeds immediately[2] to point out the great importance of the distinction between 'fixed capital' and 'circulating

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[1] *Capital Currency and Banking*, 2nd edition, p. 84.
[2] *Ibid.*, p. 85.

CHAP. V. capital,'[1] a distinction which, he truly observes, is the basis of 'what are, and what are not, proper banking securities;'[2] because 'no community can, without the greatest inconvenience and derangement, increase its fixed capital faster than it is able to spare labour from the production of those commodities on which the community relies for its daily subsistence.'[3] Yet, immediately after showing, most forcibly, the importance of the distinction, he occasionally drops the distinctive names, and uses 'capital' to mean only circulating capital. For instance, he says: 'In fact, capital is constituted of commodities which are transferred from hand to hand.'[4] Again: 'The possession of capital is merely the command over commodities of various kinds.'[5] The context in these cases shows that 'circulating capital' only is intended. Whilst such use of the name is inconsistent with his own definition, it is accordant to common professional use, which, as stated above, uses 'capital' in a general sense, to signify circulating capital, and depends upon the special context to indicate any wider or different sense.

Again, Ricardo says, 'According as capital is rapidly perishable and requires to be frequently reproduced, or

[1] Mr. Wilson uses the name 'floating capital;' but the name 'circulating capital' is substituted in the text, in accordance to the preference of the latter in other parts of this treatise.

[2] *Capital Currency and Banking*, 2nd edition, pp. 87, 91.

[3] *Ibid.*

[4] *Ibid.*, pp. 96, 99.

[5] *Ibid.*

is of slow consumption, it is classed under the head of 'circulating or fixed capital,' and, he observes in a note, that 'this division is not essential.'[1] Yet he immediately afterwards shows it to be essential, by pointing out that the division 'introduces a considerable modification' of a law of value which he had offered as fundamental.[2] CHAP. V.

Science should conform, so far as consistent with scientific accuracy, to common use of terms, but cannot accept any avoidable ambiguity. These conditions seem to be met by the definition obtained above, that *capital is whatever can support labour, or can be readily exchanged for what will do so.* With the utmost practicable agreement, as we believe, with both common professional and scientific use, we retain capital, labour, and natural agents (the last commonly represented by land) as the three indispensable elements of production; whilst 'fixed capital' denotes something which aids labour and makes it more productive, although it cannot support labour, and cannot, ordinarily, be exchanged for what will do so.

Money is the representative of capital.

Any larger definition of capital places its relation to money in inextricable confusion. It was shown (chap. iv., prop. 5) that money represents things seeking exchange by means of money and nothing else. But things effectively seeking exchange by means of money are

[1] *Principles of Political Economy and Taxation*, 2nd edition, p. 20.
[2] *Ibid.*

CHAP. V. things which either can support labour or (as proved by the mere fact of being exchangeable for money) can be exchanged for what will do so. Consequently, money is the representative of circulating capital and not of fixed capital, a distinction of fundamental importance in banking and commerce (as will be shown hereafter in the chapters on banking and trade); a distinction which alone is sufficient reason for restricting the name 'capital' to circulating capital; and which is, probably, the real reason for the very general professional use of the term in that restricted sense.

As respects some things, their character as capital depends upon circumstances.

Seeing that, as respects many things, according to the above definition, the question whether they be capital or not depends upon whether they can be readily exchanged for what will support labour, it is inferable that some things have, or have not, the character of capital, according to varying circumstances. This inference agrees with common experience. For, in any country, there is a large quantity of things which are not necessaries of life, in any proximate sense, of which some part is used for home consumption and another part is readily exchangeable, for necessaries of life if need be, abroad.

There is a considerable demand by other countries for French bijouterie and German toys; and, so far, these things can sustain the labour of those countries by exchange, and are part of the respective national capitals. But, so far as such things are used only by the nation

which produces them, they cannot sustain labour, either directly or indirectly, and they form no part of the national capital. These things, however, are capital to the individual producers, because these can exchange them for necessaries of life. Again, many things which cannot be national capital under any circumstances, may be regarded as the capital of individual persons. A private person may regard his land as equivalent to capital with reference to his ability to sell it for capital at his pleasure; whilst a nation cannot regard its land as equivalent to national capital, because it neither directly supports labour during production, nor can be exchanged for what will do so.

There is, of course, no absolute distinction of 'necessaries of life.' We may repeat what was said in Chapter II., that there are, at any given time, certain things which are necessary for the support of each kind of labour, in the practical sense that the labourers of that class, under their then present circumstances, will not work without them. The standard of such needs varies in different employments, in different countries, in different generations. What is, in this sense, necessary at one time and in one class, may be a comparative luxury in another. Still, although there be things which it is difficult to assign exclusively to the class of necessaries or of non-necessaries, yet the broad distinction remains that the whole community is sustained by means of 'necessaries of life,' either produced directly, or obtained

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by produce given in exchange, *i.e.*, the whole community is sustained by capital. It is evident that this capital is continually consumed and reproduced.

Capital is continually consumed and reproduced.

We may here recapitulate the definitions and principal propositions in this chapter.

Summary of principal propositions in this chapter.

1. Capital is whatever can support labour, or can be readily exchanged for what will do so.
2. 'Fixed capital' comprises all artificial aids to production which make labour more productive, but which cannot support labour, and cannot, ordinarily, be exchanged for what will do so.
3. Some things have or have not the character of capital according to varying circumstances.
4. Capital is continually consumed and reproduced.
5. Money is the representative of capital.

Various definitions of capital.

NOTE.—The following are some of the formal definitions of 'capital' offered by various writers:—

By Ricardo.

'That part of the wealth of a country which is employed in production, and consists of food, clothing, tools, raw material, machinery, &c., as necessary to give effect to labour.'[1]

In the first place, by saying that which '*is* employed' instead of '*can* be employed,' the definition excludes all the large quantity of food and other things consumed by

[1] *Principles of Political Economy and Taxation*, 2nd edition, p. 86.

non-productive persons. These, according to the definition, do not consume capital. Moreover, the definition leaves it doubtful whether the produce of the labour available for profitable foreign exchange is part of the capital of the country. For instance, whether manufactured cotton goods ready for export be capital of this country. CHAP. V

By Macleod:

'An economic element devoted to purposes of profit.'

And he defines an 'economic element' to be 'whatever has value that can be measured,' or 'whatever can be bought or sold.' [1]

There is the same objection to the condition of 'purposes of profit' as in the foregoing to the condition of '*is* employed in production.' According to the literal definition, unproductive consumption of food, &c., does not consume capital; otherwise it is evident that the definition of capital as whatever may be bought or sold, approaches nearly our proposed definition of 'whatever can support labour, or can be readily exchanged for what will do so.' But this last preserves the distinction of capital and labour; and seems, thereby, more perfectly to exhibit and reconcile the fundamental notion, common use and scientific needs. MacLeod's definition merges the class 'labour' in the class 'capital.' It is, in some respects, as if a naturalist, finding it impossible to draw the exact line between the animal and vegetable kingdoms, should avoid ambiguity by abandoning the distinction

[1] *Dictionary of Political Economy*, p. 33.

CHAP. V. altogether, and by defining animals in a manner which should include all living organisms. Common use does not admit such an extension of the term 'capital' as to include all 'labour;' and scientific needs require the separate classification of things which will support labour either directly or indirectly, whether we name the class 'capital' or not.

By Mill.

'What capital does for production is to afford the shelter, protection, tools, and materials which the work requires, and to feed and otherwise maintain the labourers during the process. These are the services which present labour requires from past, and from the produce of past labour. Whatever things are destined for this use, destined to supply productive labour with the various pre-requisites, are capital.'[1] Mill defines 'productive labour' to be labour which 'increases, or tends to increase, material wealth.'[2]

The same objection holds to this as to the foregoing definitions, *viz.*, that by restricting capital to that which is *destined* to supply labour with its pre-requisites, it involves, literally, the practical absurdity that the large portion of the community which produces nothing does not consume capital. This definition moreover, by the special sense in which the term 'productive labour' is used by Mill, goes further, and implies that labour

[1] *Principles of Political Economy*, 5th edition, Book I., chap. iv.
[2] *Ibid.*, Book I., chap. iii.

which does not increase or tend to increase material wealth is not sustained by capital. CHAP. V.

By MacCulloch.

"'That portion of the produce of industry existing in a country, which can be made directly available either for the support of human existence or the facilitating of production.' [1]

It is evident that the words 'whatever things' might be advantageously substituted for the words 'that portion of the produce of industry existing in a country.' So far as this definition includes the things which *can* be made available for the support of human existence, instead of restricting capital (as by the previous definitions) to the things which are, or are destined to be, made available for the support of those human beings who are engaged in a particular occupation, it is preferable. But the word 'directly' mars the definition. It excludes gold or goods available for export, and perhaps actually intended for export, in exchange for goods. In fact it excludes everything which, though it will not directly sustain labour, is readily exchangeable for what will do so.

By Fawcett.

'The wealth which has been accumulated with the object of assisting production.' [2]

Here, again, the nature of 'capital' is made to depend upon the purpose to which it is applied. According

[1] *Dictionary of Commerce.*

[2] *Manual of Political Economy*, Book I., chap. iv.

CHAP. V. to this definition, food saved to support unproductive persons is not capital; and unproductive persons do not consume capital.

By Wilson.

'Capital consists of all improvements in the natural elements of production, of all implements which facilitate production, and of all commodities which, though produced for consumption, yet the value of which will be replaced to the producers from the incomes of those who consume them. Thus permanent improvements on land, by which larger crops are obtained by the same labour; improvements in water courses, rivers, or docks; the construction of canals, roads, or railways, which facilitate intercourse; and the exchange of commodities, buildings, ships, machines, cattle, all implements of reproduction and commodities of every description, such as cloth, wheat, sugar, gold, silver, iron, &c., which are produced for the purpose of sale, the price of which is to be replaced from the income of the consumers, while the profit only is to be consumed by the producers, constitute the capital of a nation.' [1]

If 'improvements of natural elements of production' be capital, it must be difficult, practically, to distinguish 'capital' and 'natural agents.' There is a great ambiguity in the words 'commodities of every description such as,' &c. Presuming that the words mean 'everything of the same description as the things named,' it is

[1] *Capital Currency and Banking*, 2nd edition, p. 84.

doubtful what is the common description intended. The things named are either those which directly sustain labour, or are things which are ordinarily exchangeable abroad for what will do so. So limited, the things, doubtlessly, constitute the capital of the nation ; and, so interpreted, that part of the definition concurs with that which is proposed in this treatise.

CHAPTER VI.

PRODUCTION.

CHAP. VI. WE have used the term 'Production' in the previous chapters in its natural and obvious sense.

Definition of production.

If one man till the ground and another paints pictures or writes poems, the labour of each is productive, in the sense that one produces, say, corn, and the other pictures or poems. There is, however, the important distinction that one produces what will directly aid further production, and the other what will not do so. It is only the kind of labour represented in the foregoing comparison by 'tillage' which makes the other kind of labour possible. The necessity for this distinctive classification arises from the fact that the expenditure which does not aid further production, whether it provide things as inestimable as great works of art, or as worthless as mere pageantry, does expend the wealth of the country without return; whilst the expenditure which aids further production increases the general wealth. It is consequently needful to class all labour in these two categories. For this purpose some writers name the two classes 'productive expenditure'

and 'unproductive expenditure' respectively. But this seems a needless inaccuracy of language. It seems most convenient to name the expenditure which aids further production 'reproductive expenditure,' and that which will not aid further production 'unreproductive.'

Distinction of 'reproductive' and 'unreproductive expenditure.'

Expenditure, however, which is unreproductive, in the above sense, to the whole community, may be reproductive to him who makes it. The painter may sell his pictures profitably, and so his labour may be to him a means of further production.

Similarly, expenditure which is unreproductive in the sense that it produces what will not, in its own nature, aid further production, may yet be reproductive to a community, because it can be exchanged with another community for what will aid further production. A manufacture of bijouterie is reproductive to the community which exports it.

It is, therefore, always needful to judge by the context whether reproductiveness or unreproductiveness is predicated in relation to a single person, to a section of a community, to a whole community or nation, or to the whole intertrading world.

Although the whole community depends upon reproductive expenditure of labour and capital, yet no generally superior worth is attributable to reproductive labour on that account. The labour of the quarryman or brickmaker alone makes the work of the architect possible; but we do not attribute any superiority to

The whole community is sustained by reproductive labour.

CHAP. VI. the former. On the other hand, there is no necessary superiority in unreproductive labour; it includes alike the work of the poet and the mountebank. We merely note the economically important fact, that it is only reproductive labour which makes unreproductive labour or idleness possible.

Summary of propositions in this chapter.

The definitions and propositions implied in this chapter:—

1. *Production* is any conversion of labour or capital as distinguished from mere consumption of these.
2. *Reproductive expenditure* is employment of labour or capital to produce that which will directly aid further production.
3. *Unreproductive expenditure* is the employment of labour or capital on that which will not directly aid further production.
4. It is only 'reproductive expenditure' which makes 'unreproductive expenditure' or idleness possible.

CHAPTER VII.

COST OF PRODUCTION.

The elements of cost of production.

THE elements of production being natural agents, labour and capital; and the force of natural agents being constant; and the cost of labour being the capital expended in sustaining the labour; it follows that the cost of production is the capital expended in production.

The capital expended in production may be subdivided as follows:

Capital expended as raw material.

Capital expended in sustaining labour.

Capital expended in providing and maintaining machinery (fixed capital) used in the production.

The measure of the cost of the use of fixed capital.

The whole cost of providing and maintaining machinery, or fixed capital, belongs to an indefinite quantity of produce. We must consider, therefore, what is the measure of this element of cost as applied to a given quantity of produce. It was shown (chap. ii., prop. 3) that all capital may ordinarily be made to reproduce itself with some excess. Remembering this, it is evident that the measure of the perpetual cost of the fixed

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capital, is the excess which would have been obtainable at successive intervals by other employment of the capital which produced the fixed capital. And the measure of that element of cost, as applied to a given quantity of produce, is the 'excess' otherwise procurable in the period occupied in the production of the given quantity.

Moreover, when land, or any other natural agent, has become so exclusively appropriated that a payment can be obtained for its use; this payment *sometimes* becomes another element in the cost of production of some things.

The payments for labour being termed 'wages,' and the payments for the use of machinery (fixed capital), or of exclusively appropriated natural agents, being termed 'rent,' we may describe the elements of the cost of production as

Capital expended as raw material.

Capital expended as wages.

Capital expended as rent.

The conditions on which rent of natural agents enters into cost of production.

It was said above, that payment for the use of an exclusively appropriated natural agent sometimes becomes an element in the cost of production of some things. This qualified statement requires proof. In what sense rent, paid for the use of natural agents, enters into the cost of production, is a point which it is important to apprehend clearly, but which cannot be fully elucidated until the nature of rent shall have been more completely exhibited. An immediate answer,

however, may be given, that the question of whether rent of natural agents enters into cost of production, depends upon whether we regard that cost in relation to the individual producers or to the community. It is evident that rent of natural agents is different from any other expenditure connected with production, inasmuch as it does not directly or necessarily entail any consumption of capital. It only causes the transfer of capital from one person to another. The use of 'labour' and of 'machinery' is necessarily attended by consumption of capital to sustain the labour, and to provide and maintain the machinery. The use of natural agents involves no consumption of capital. To the farmer of land, the rent forms part of the cost at which he individually produces the corn or other produce. On the other hand, to the community generally, it forms no part of the cost of production, because it entails no additional expenditure of capital by the community.

CHAPTER VIII.

THE ELEMENTS OF INCREASE OF WEALTH.

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IN Chapter III. we showed wealth to be whatever enables persons or communities to be, in any degree, independent of their own labour for the supply of their needs. It is not identical with capital. It evidently includes fixed capital which aids or diminishes labour, such as needful buildings, roads, canals, docks, and machinery of all kinds. By similar reasoning, national wealth must include all exceptional natural advantages which aid or diminish labour; and which, by comparatively exclusive appropriation, give to the produce of labour a high exchange value with other communities. Such are the exceptional facilities for producing wine in some countries, the possession of coal and iron in close proximity in Great Britain, the peculiar fitness of some parts of India for producing opium and indigo, and other such cases.

The sources and elements of wealth.

We see that the only sources of wealth are industry and natural agencies. We cannot call industry a part of wealth, though it is a source of it, because the nature

of wealth is to diminish the absolute necessity for industry. We also reasonably exclude all the natural productive forces which are common to all people. So that wealth may be regarded as consisting of all peculiar facilities for production, and the products of these obtained by industry. In other words, wealth consists of capital, accumulated fixed capital (*i.e.*, all artificial aids to production), and exclusively appropriated natural advantages. It can only be increased by well applied industry in reproductive expenditure of labour and capital.

The means and limits of accumulation of wealth.

Such being the sources and elements of wealth, we may see the means and limits of the accumulation of it. Capital, for the most part, is constantly consumed and reproduced (chap. v., prop. 4). The means of sustaining labour in which capital consists (either directly in its nature or indirectly in its capability of exchange (chap. v., prop. 1), are of so perishable a nature that they cannot be greatly accumulated. They would be consumed by natural decay. A person or community cannot live upon fixed capital or upon mere natural advantages. How, then, is great wealth accumulated?

It will facilitate a clear conception of the matter if we consider the cases of national and private wealth separately.

First, we will consider national wealth, or the wealth of a community as a whole.

Any community can, of course, grow more and more How

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national wealth is accumulated.

wealthy by increased industry; that is to say, increasing industry will free an increasing portion of the community from the necessity of labour to supply the necessaries of life, until individual industry has attained its maximum. But a community cannot store or accumulate its own labour. It is evident, therefore, that a community isolated from the rest of the world, after developing the utmost individual industry, could only grow more wealthy by scientific development of productive natural agencies, and by accumulating fixed capital (machinery in a large sense) to aid reproductive labour more and more, and so producing the necessaries of life with less and less labour; and so freeing more and more labour for the provision of every other desirable thing or occupation which does not support of aid production. But, in fact, each community is not isolated, but has more or less commerce with other communities; and peculiar natural advantages are liable to be introduced as another means of increasing the wealth of the community. One community may have advantage over others in the comparatively exclusive possession of certain natural products, or in special aptitude for certain work. These advantages may enable it to exchange its produce for more capital than it could have produced by equal labour in its own country. For instance, the exclusive possession by India of the means of producing the best kind of opium enables her to obtain annually from China ten to twelve

millions worth of produce for what costs her a comparatively small expenditure of capital. The possession by Great Britain of coal and iron mines in close proximity, and the consequently acquired aptitude for certain manufactures, enables her to obtain, by exchange, a far greater quantity of the things she needs than she could produce directly by her own labour.

Further, it is evident that the general wealth must be increased by each producer being occupied, so far as possible, in producing that which he is most fitted by circumstances to produce; so, by exchange, obtaining everything at the least cost of labour and capital.

Thus we see that the means of general wealth are personal industry, the development of scientific and mechanical aids to labour, and good economy of exchange.

By each of these means a larger portion of the community is freed from the necessity to engage in reproductive labour. Speaking generally, *the wealth of a community is measured by the degree to which the labour of a few suffices to provide the necessaries of life for many; so freeing the largest possible part of the labour of the community for every other desirable occupation.*

No definite limit to the increase of wealth.

There is no definite limit to the increase of the general wealth by the above stated means, especially by the mechanical and other scientific means. Mechanical means have already been made a substitute for labour, to an extent which would have been thought impossible

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a century ago, and it is impossible to assign any limit to their possible development.

The nature of the wealth of a single person.

The nature of the wealth of a single person is not always perfectly analogous to the wealth of a nation. We see that a man ordinarily acquires wealth by obtaining in exchange for his own skill or industry more money than he expends on his own sustenance; and by accumulating either this excess of money, or generally desirable things obtained by the money, and capable of being re-exchanged for money. Remembering that the force of money was shown (chap. iv., prop. 4) to be its command of what will support labour, and consequently its command of labour, we see that *the wealth of a private person consists in what will command the labour, or produce of labour, of others.* The individual accumulation may be further indefinitely augmented by inheritance or other gratuitous transfer.

Distinctive character of private and national wealth.

We thus see that the wealth of a single person differs in its nature from the wealth of a large community or nation, in that the nation cannot store or accumulate its command of labour, and cannot accumulate capital indefinitely because of its perishable nature; whilst the single person can accumulate indefinitely his command of the labour of the rest, and so can accumulate indefinitely the command of capital within the one absolute limit of the productive power of the whole community in excess of its own sustenance. Nevertheless, the wealth of a single nation in relation to the rest of the world is

perfectly analogous to that of a single person in relation to the rest of his nation. Its advantages may give it, to a certain extent, a command over the labour of the rest of the world, as in the instances already noted in this chapter.

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On the other hand, the civilised world, viewed as one large isolated community, cannot accumulate capital indefinitely because of its perishable nature. It can only increase its wealth by personal industry, by development of scientific and mechanical aids to labour, and by commercial economy. By each of these means a larger portion of mankind is freed from the *necessity* to engage in reproductive labour.

The possibl
increa
of gen
wealth

It is evident, from the foregoing considerations, that the employment of an unusually large portion of a community in reproductive work, although a means of wealth, is a sign of present poverty; just as a large unreproductive expenditure is a sign of present wealth. A luxurious house and table, many servants and equipages, are signs of present wealth but not sources of it. The employment of every member of a family in reproductive work is a means of wealth, but a sign of present poverty. It is the same with a nation.

Signs
wealth
and
poverty.

To resume:—The principal facts and inferences exhibited in this chapter, are—

Summary
of princi
pal prop
sitions.

1. The sources of wealth are industry and natural advantages.
2. Wealth in its general character consists of capital,

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fixed capital, and exclusively appropriated natural advantages.

3. The wealth of a nation or large community is measured by the degree to which the labour of a few suffices to provide for the mere necessities of many; and, consequently, by the degree to which the industry of the community is freed for every desirable occupation other than the provision of those mere necessities.

4. The separate wealth of a single person consists in the exclusive possession of that which will procure the labour, or produce of labour, of others. In other words, it consists in an acquired right to, or command of, the labour of others.

5. A nation or large community increases in wealth by general industry, by accumulation of fixed capital, and by good commercial economy to provide that each portion of the community shall be occupied principally in producing that which it is best fitted to produce.

6. The possible accumulation of wealth by a single person by means of industry, thrift, and inheritance, is indefinite, within the absolute limit of the productive power of the whole community in excess of its own sustenance.

7. The possible increase of the wealth of a community or of the whole civilised world, by artificial means of aiding labour and increasing production, is indefinite.

CHAPTER IX.

VALUE.

VALUE, as a term of the science of Political Economy, means, by consent of both common and scientific use, only value in exchange, *i.e.*, the purchasing power of anything. If a man, being in need of money, procures it by selling a picture, it is quite as true that the picture buys the money as that the money buys the picture. The science takes no account of other kinds of value, such, for instance, as the historical value of the picture.

The cau e of value.

Desire for a thing, and the exclusive possession of it, are evidently the causes of value. A thing may be ever so costly to procure, but it has no value if no one desires it. Mud dredged from the depth of the ocean would be enormously costly, but would be of as little value as the sand on the shore. The air we breathe is absolutely indispensable, but it has no value because it is not exclusively appropriated.

It is obvious that desire for exclusively appropriated things operates only by demand (demand by those able and willing to give certain quantities of other things in exchange).

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How relative value is determined.

Though desire and exclusive appropriation are the causes of value, we have to consider what determines relative value, *i.e.*, what determines the relative quantities in which things exchange with each other. Supposing that fifty pounds of meat are equivalent in the market to one hundred pounds of bread, what determines this rate of exchange?

We see that, as a matter of fact, the relative value of the bread and meat is immediately determined only by the tentative bargaining of the market. The relative value is the result of two forces—the desire of sellers to receive as much as possible, and of buyers to give as little as possible in exchange. The separate bargains have different results; but these become known, and they become precedents which narrow the basis of dispute; and thus, in respect of many things in constant demand, there is not a very great difference in contemporaneous values under similar circumstances. This is eminently the case in respect of common articles of food.

The relative strength of these two forces must of course depend upon the relative urgency of the needs of the buyers and sellers respectively.

Let us suppose that the cost of producing a given weight of meat is only double the cost of producing the same weight of bread; but that the butchers, for a time, demand a value which would purchase five times the weight in bread; and that there is so urgent a demand for meat, that all which is offered in the market is taken

at that value. By the hypothesis, it is evident that it could be sold profitably at a much lower value. Common experience shows that, in such a case, the following tendencies to diminution of value come into operation. The extraordinary profit tempts each one engaged in the trade to increase his own business by slightly underselling his neighbour; a motive which, in many cases, is perfectly effective to keep values below those which would give extraordinary profit. The desire to sell as much as possible at profitable rates, leads also to a generally increased supply, and, by consequence (as shown in chap. ii., prop. 14), to a diminution of value. Moreover, if, from any cause, values giving extraordinary profits are maintained for a considerable time, there is an increased inducement to people not previously connected with the trade to enter on it; so increasing the competition of sellers, and so diminishing the value. There is constant experience of these tendencies in the case of nearly all articles in general demand; and it is seen that one or other, or all, are effective to prevent the endurance of extraordinarily high values (values very greatly in excess of cost of production); excepting in those rare cases in which the whole source of supply is controlled by a few who act in concert; and excepting also those cases in which, for any reason, the occupation is specially disagreeable. By these means we see that the price of meat, in the case supposed above, would be greatly diminished; but not, perhaps, to the point at which the

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respective values of meat and bread would be exactly proportionate to the cost of production. The mere distastefulness of the butcher's trade would, perhaps, diminish the force of competition; whilst, in the case of production of bread, any attempt of the bakers to maintain high values would be so easily defeated by people baking at home, that competition, in that case, would probably be at its maximum force; and thus bread might be permanently cheaper, in relation to cost of production, than meat. This appears to be the actual fact.

Values of things in constant demand, and producible in indefinite quantities, tend to be proportionate to cost of production.

It is evident that, with respect to things in constant demand and producible in indefinite quantities, all the foregoing motives must exist (although with a force constantly diminished as values are diminished) until the value of anything be such that the occupation of producing it does not afford more than ordinary attraction. It is evident, by further consequence, that all such values may be said to *tend* to have the same proportion to cost of production; although this tendency is limited by many circumstances, especially by every case of defective supply. As the cost of production is the lowest remunerative value, it may be said, by further consequence, that values of such things *tend* to the cost of production. But common experience shows the tendency to be effectively counteracted in many cases. This only is sure, that the values of such things cannot fall below the cost of production without inducing a reaction by diminished supply. They cannot rise indefinitely above

the cost of production without causing reaction by competition of producers and increased supply.

Limitation of the supposition that regulates value.

Consequently, on the foregoing considerations, it is often said that cost of production regulates value. It is a very imperfect statement. In the first place, we see that it is only true, in any sense, with respect to things of which constant fresh supplies are needed, and which can be produced in indefinite quantities. There is a constant demand for the works of eminent artists; but the supply cannot be indefinitely extended, and the value is notoriously independent of the cost of production. On the other hand, there are things in so little demand that their value may fall to any extent below he cost of production. For instance, things which have gone out of fashion are frequently sold at less than their cost of production.

Moreover, even in the case of things producible in indefinite quantities, it is shown above, by the case of the butcher's and baker's trades, how comparative difficulty and comparative unattractiveness may keep values in unequal relation to cost of production. Again, although a thing be capable of indefinite increase, yet if the demand increase rather more quickly than the supply, the value may be maintained above what it would otherwise be. The iron trade in England, of late years, seemed to afford a good instance of this. Indeed, the constant experience of different values of similar things, for reasons which the most forced con-

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struction cannot translate into differences of cost of production, contradicts the assumption of more than a *tendency* of value to correspond with cost of production; a tendency counteracted by many other tendencies.

Sometimes it is said that values are determined *immediately* by demand and supply, but *ultimately* by cost of production. If this only means that cost of production gives a limit of value, below which production will not permanently continue, it is an inaccurate and needlessly obscure mode of stating the fact. But taking the statement in its literal sense, it is obvious that if values are at all times immediately determined by the relation of demand and supply, the *ultimate* determination by something else can never happen until demand and supply are in all cases wholly, and therefore in all cases equally, determined by that something else. But experience contradicts the anticipation of demand and supply being in all cases wholly regulated by cost of production. It is only the range of fluctuation of value which is limited by cost of production.[1]

[1] The most eminent writers who maintain the theory of value being ultimately determined by cost of production, make it tenable by hypothetical limitations of the general problem of value which the facts present. Ricardo, for instance, says that he includes in his theory of value 'only such commodities as can be increased in quantity by the exertion of human industry, and in the production of which competition acts without restraint' (*Principles of Political Economy and Taxation*, 2nd edition, p. 3); and he assumes that, in the early stages of society, the rule which determines how much of one such commodity shall be given in exchange for another, depends solely on the comparative quantity of labour expended on each.

Mill says: 'The cases I contemplate are those in which prices and values are determined by competition alone (*Principles of Political*

The effect of cost of production on value seems, therefore, to be accurately stated as follows:—

An increase of cost of production being, in effect, decrease of supply of the means of production, *tends to increase of value* (chap. ii., prop. 14). Similarly, *a decrease of cost of production tends to decrease of value.*

The effects of cost of production on value.

With respect to things in constant demand, and producible in indefinite quantities, the values cannot fall below the cost of production without producing a reaction

Economy, Book III., chap. i. § 5). Again, he says that his theory of value only 'contemplates a system of production carried on by capitalists for profit, and not by labourers for subsistence' (Book III., chap. vi. § 2). He adds: 'The value at any particular time is the result of supply and demand, and is always that which is necessary to create a market for the existing supply' (Book III., chap. iii. § 1). 'The real law of supply and demand holds good in all cases. But in all things which admit of indefinite multiplication, demand and supply only determine the perturbations of value during a period which cannot exceed the length of time necessary for altering the supply. While thus ruling the oscillations of value, they themselves obey a superior force, which makes value gravitate toward cost of production, and which would settle and keep it there, if fresh disturbing influences were not continually arising to make it again deviate.' 'Demand and supply always rush to an equilibrium; but the condition of stable equilibrium is when things exchange for each other according to their cost of production' (Book III., chap. iii. § 2).

In his conclusion that values gravitate toward cost of production, whilst fresh disturbing influences continually arise, he only says that which we have stated in the text above. It is not the tendency of values to cost of production, but the ultimately complete effectiveness of the tendency which we have denied.

If the objection to the theory depended on denying the ultimate concurrence of all influences with the one influence of cost of production *under the assumed limitation*, it would be needful to argue that point thoroughly. But our objection to the theory is not that it is false under the conditions stated or implied, but that it is too narrow. We need a theory of value which applies to all cases; and such is Mill's own theory of the equation of supply and demand.

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by diminished supply; and they cannot rise indefinitely above the cost of production without causing reaction by increased supply.

Some values are permanently much in excess of the cost of production, because there cannot be a supply equal to what the demand would be at a lower rate. Wines of a choice vineyard are familiar instances of this class of things.

Distinction of kinds of scarcity values.

It is needful, however, to distinguish two kinds of scarcity values. One which is due only to scarcity of the least costly means of supply (as in the case of a thing which can be produced in indefinite quantity, but at a continually increasing rate of cost for additional quantities); and the other which is due to absolute restriction of the quantity of produce. Agricultural produce is an instance of the first kind, because there is no assignable limit of possible increase of production from the land, if cost be disregarded. Of the second kind of scarcity value, the works of distinguished artists afford good instances. This latter kind of scarcity value is sometimes styled a monopoly value. But the convenience of the name hardly warrants the inaccuracy. A monopoly of anything is the exclusive control of the supply of it; and this is not a necessarily attendant circumstance of the stated kind of scarcity.

The value of the whole of any produce is

If one kind of produce be produced under various conditions, so that under some the cost of production is less than under others, the value of that produce must be de-

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termined by the value of the most costly part. For, suppose for instance that imported wheat, as good as home-grown wheat, could be profitably sold at forty shillings the quarter, whilst home-grown wheat could not be profitably sold under forty-five shillings, and that the imported wheat were actually offered at the lower price; we know that there would be immediately such an exclusive demand for the imported wheat as would at once raise the price (chap. ii. prop. 13), and would continue to do so until it should rise to the price of the home-grown wheat, which, by the hypothesis, could not be permanently less than forty-five shillings without causing a discontinuance of the supply of home-grown wheat.

determined by the value of the most costly part.

It is an obvious inference from the foregoing propositions that *it is only by actual restriction of the supply that monopoly* (the exclusive control of the supply of anything) *can raise the value of any produce permanently beyond what it would otherwise be.*

Monopoly can only raise the value of produce by restriction of the supply.

A general rise or fall of values is a statement without meaning. If only three exchangeable things existed, the value of one, or of two, might rise or fall, *i.e.*, one might exchange for more or less of the two other things. But a rise or fall in the value of all three has no meaning. It is equivalent to the statement that three things can all simultaneously become bigger or smaller than each other. Obvious as this is, it is needful to bear it in mind.

A general rise or fall of values has no meaning.

Before concluding this chapter it may be well to ex-

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hibit the relation of supply and demand in a somewhat different manner, so as to secure an accurate apprehension of the sense in which value is determined by that relation.

All kinds of produce offered in exchange may be classed in three categories :—

Further illustration of the theory of value.

1. Those which can be produced in indefinite quantities at the same rate of cost.

2. Those which are absolutely limited in quantity.

3. Those which can be produced in indefinite quantities, but at a constantly increasing rate of cost.

As an example of the first class, let us take the case of a certain kind of cotton cloth which is produced at a cost of threepence a yard. This, therefore, is the lowest remunerative value at which it can be sold. We know that the demand for such things increases and decreases as the value falls or rises. There is, therefore, a certain quantity of this cloth which would be demanded if it were sold at threepence a yard. If the supply be less than that quantity, and it nevertheless be offered for sale at threepence in the first instance, there must be competition for it, which competition would raise the value and diminish the demand (chap. ii., prop. 13 and 14). This evidently operates until the value and demand correspond. For, if we suppose the value to rise higher than is needful to diminish the demand to the measure of the supply, the demand would fall below the supply, causing a competition amongst sellers (chap ii.,

prop. 13 and 14), so diminishing the value. These tendencies must remain in force until demand and supply correspond, in the sense that the value is such as keeps the supply equal to the demand.

For an example of the second class, let us take the works of a great artist of a past generation. It is evident that cost of production may be wholly unascertainable, and in any case has nothing to do with the value. What is the relation of supply and demand in this case? The demanders compete and raise the price, until the price excludes some of the poorest or least eager. The competition of the remainder continues to raise the price; and so, more and more of the demanders are excluded by the value rising beyond what they are able or willing to give; until the value has become so great that the number willing to pay it, corresponds with the supply. In other words, the competition due to scarcity, raises the value, until the demand at that value, equals the supply.

The converse evidently holds good that the competition of sellers due to a supply in excess of demand at a given value, diminishes the value, until the demand at the diminished value equals the supply.

In considering the third class of produce, let us take the case of corn; and let us suppose that there is a supply less than the demand at the existing value; and that more can be supplied only at an increased cost of production. The deficient supply raises the value, so

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inducing increased supply; and this process must continue until the value has attained the point at which demand and supply correspond.

Value depends upon equation of supply and demand.

The foregoing is best expressed (as by Mill) by the statement that *value depends upon the equation of supply and demand.*

We have considered value without special reference to money. The intervention of money will be considered in the next chapter. It will appear that the use of money in no degree affects the propositions in this chapter.

Summary of principal propositions in the chapter.

The principal propositions exhibited in this chapter are

1. Desire (operating by demand) and exclusive appropriation, are the causes of value.
2. Value is determined by equation of supply and demand.
3. An increase of cost of production tends to diminution of supply and increase of value; and a decrease of cost of production tends to increase of supply and diminution of value.
4. With respect to things in constant demand and producible in indefinite quantities, their values cannot fall below the cost of production without producing a reaction by diminished supply; and they cannot rise indefinitely beyond the cost of production, without causing reaction by increased supply.

5. The value of things absolutely limited in quantity, may rise indefinitely.
6. Monopoly can raise the value of any produce only by restriction of the supply.
7. If one kind of produce be produced under various conditions, so that, under some, the cost of production is less than under others; the value of the whole tends to, and cannot be permanently less than, the cost of production of the most costly part.
8. A general rise or fall of values, is a statement without meaning.

CHAPTER X.

PRICE.

CHAP. X. THE price of anything is its *value expressed in money.* If, therefore, 100 pounds of bread exchange for 50 pounds of meat or for 20 pounds of cloth; the several prices of these three quantities must be the same. If the price of one of these quantities be a certain quantity of money; the price of each of the others must be the same quantity of money. But we have to determine the positive quantity; why it should be one sum of money rather than another.

How prices are determined.

The general explanation of this question is inferable by analogy, although it is not obvious to ordinary experience. We know that, in past times, prices were generally very much lower than at present, and that, at the same time, the quantity of money was very much less in proportion to the numbers of the community. Froude, for instance, in his 'History of England,' gives, as the result of his inquiry, that a given quantity of gold or silver at the beginning of the sixteenth century would purchase twelve times as much as at present. That the quantity

of money was very much less in proportion to the population is proved by the fact that the incomes of every class from the Sovereign to the artisan were far smaller than those of the corresponding classes at the present day.[1] The evidence of prices having been lower when gold and silver were scarcer, and of prices rising as those metals become more abundant, might be multiplied indefinitely. That this should be so is inferable from the propositions established in Chapters II., IV., and IX. Money was shown, in Chapter IV., to be a commodity used as a means of exchange and measure of value. Regarding money as a desired commodity, the more plentiful it is, the less must be its value (Chap. II., Prop. xiv.), *i.e.* the more of it must be given for a certain quantity of other produce; and more money given is higher price. Regarding money as a measure of value, it is obvious that if the whole quantity of money represents, in some sense, all the goods seeking exchange; the larger may be the quantity which represents the whole, the larger must be the quantity which represents any part, *i.e.* the higher must be the price of any part. In short, money may be regarded as one commodity; and the

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[1] In Nicholas's account of the Privy Purse expenses of Elizabeth of York, he shows, as examples of the value of money at that period (the latter part of the fifteenth century) that the highest salary of any of the Queen's ladies was 33*l.* 6*s.* 8*d.* a year, and the lowest 5*l.* For the support of two nephews and a niece of the Queen and two women-servants and a man-servant, only 13*s.* 4*d.* a week was allowed. A surgeon's fee for going from London to Richmond to attend the Queen was 13*s.* 4*d.* Workmen's wages were about 6*d.* a day.

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price of any other commodity means its power to purchase money, or its value in exchange with the commodity used as money.

Cause of a general rise of prices.

On the foregoing considerations, we cannot doubt that the general explanation of the tendency of prices to rise, which is exhibited by comparison of past prices at long intervals, is the increased quantity of gold and silver in the intertrading world; and that the particular price of anything (its value in exchange for the things used as money), is determined, like every other value, by the tentative bargaining of the market, or, in other words, by the equation of supply and demand.

Cause of fluctuation of prices of particular things.

It follows also from the nature of value, as exhibited in the previous chapter, that a temporary rise or fall of price of particular things, is due to the comparative scarcity or abundance of supply or demand of those things, and not to the abundance or scarcity of money; because if it were due to the latter, the price of *all things* would be similarly affected.

Nature of a general rise or fall of prices.

It is evident, from the foregoing propositions, that a general rise or fall of prices, means a rise or fall in the value of the commodity used as money.

The foregoing general explanation that prices rise or fall according to the abundance or scarcity of the commodities used as money, is often greatly misapprehended, and is the subject of importantly erroneous inference.

We see that, independently of any permanent in-

Misapprehension of the effects of temporary inflow or outflow of money.

crease or decrease of the quantity of the commodity used as money, there are temporary fluctuations of the quantity in a given country. It is often assumed that these temporary fluctuations of quantity of money must affect prices;—that the effect on prices must react on the inflow or outflow of money;—that high prices must induce an inflow to the good market; and low prices an outflow to better markets. But experience contradicts the first assumption that temporary fluctuations of quantity of money must affect prices.

It is true that a general rise of prices cannot take place, *cæteris paribus*, without the use *i.e.* the *circulation* of more money, or of something which acts as money (how credit, especially, acts as money will be explained hereafter); and a general fall of prices cannot take place without a diminution of the quantity in circulation. This is made obvious by supposing an extreme case. If the price of everything could be immediately diminished one-half; only half the sum previously requisite, would be needed for each transaction. Consequently, one-half the quantity previously in circulation (used in exchanges) would cease to circulate. The converse, also, must hold good, that an increase of money in circulation must, *cæteris paribus*, be attended by a rise of prices. But the inference that the temporary inflow and outflow of money to and from a given country, must necessarily alter the quantity in circulation, and so cause a rise or fall of prices, is contrary to experience. The

CHAP. X. subjoined tables[1] taken from Mr. James Wilson's useful work on Banking and Currency (to which the writer of this Grammar is much indebted) show that increase and decrease of the money in circulation does not correspond, at all, with an inflow or outflow of bullion. We select two years 1857 and 1858, during which the fluctuation

[1] *Monthly average of bank notes in circulation in the United Kingdom (notes of Private and Joint Stock Banks included), and the Bullion in the Bank of England and in the Banks in Ireland and Scotland.*

1857	Total note circulation	Bullion in Bank of England	Bullion in Banks in Ireland.	Bullion in Banks in Scotland	Total Bullion in Banks.
January 17 .	38,081,668	10,176,000	2,782,796	1,814,753	14,773,549
February 14	37,733,484	10,124,000	2,711,446	1,722,403	14,557,849
March 14 .	37,046,346	10,339,000	2,589,198	1,654,254	14,582,452
April 11 .	37,849,533	9,679,000	2,493,532	1,584,726	13,757,258
May 9 . .	38,502,746	9,632,000	2,497,140	1,588,707	13,717,847
June 6 . .	37,846,376	9,995,000	2,435,478	1,790,196	13,220,674
July 4 . .	37,007,994	11,244,000	2,309,104	1,731,564	15,284,668
August 1 .	37,604,603	11,602,000	2,264,171	1,595,606	15,461,777
August 29 .	36,636,109	11,319,000	2,245,415	1,576,011	15,140,426
September 26	37,001,100	11,293,000	2,270,252	1,573,546	15,136,798
October 24 .	39,325,057	9,917,000	2,382,037	1,675,785	13,974,822
November 21	39,183,640	7,721,000	2,414,539	2,057,192	12,192,731
December 19	37,581,999	8,035,000	2,420,624	2,210,214	12,665,838
1858					
January 16 .	35,826,700	12,053,000	2,174,906	2,370,840	16,568,746
February 13	36,312,005	15,551,000	2,263,149	2,130,524	19,944,673
March 13 .	35,948,376	17,571,000	2,386,127	2,087,699	22,044,826
April 10 .	36,315,055	18,404,000	2,306,465	2,101,558	22,812,023
May 8 . .	37,588,788	18,462,000	2,289,261	2,148,611	22,897,872
June 5 . .	37,614,800	18,011,000	2,369,706	2,283,887	22,664,593
July 3 . .	36,285,919	17,978,000	2,420,017	2,329,077	22,727,094
August 1 .	36,872,318	17,196,000	2,384,027	2,318,381	21,898,408
August 28 .	36,533,800	17,420,000	2,391,694	2,313,984	22,125,678
September 25	36,730,514	18,405,000	2,422,558	2,263,662	23,091,220
October 23 .	39,107,632	19,398,000	2,455,761	2,322,879	24,176,640
November 20	39,566,528	18,722,000	2,461,716	2,696,145	23,679,861
December 18	38,226,949	18,876,000	2,501,102	2,543,905	23,921,007

of the quantity of bullion in the banks was very great. It will be seen, at a glance, how much independence there is in the fluctuation of the quantity of notes in circulation and of the quantity of available money. The fluctuation of the former is much less, and such as there is, in great measure characterises all years alike; the circulation being always least about March and greatest about November. It is true that the note circulation does not show nearly the whole circulation; but so far as the export of bullion may be made from gold in circulation, it cannot affect the bullion in the banks; and, therefore, when a large quantity of the bullion of the banks is sent abroad; a corresponding diminution of the circulation, *if any such take place*, must be shown in the note circulation. But experience shows that such corresponding diminution of the note circulation does not take place.

An outflow of money is not attended necessarily by diminished circulation.

We proceed to show that the erroneous inference above noticed regarding the effect of an inflow or outflow of bullion on prices, depends upon a disregard of the distinction of money in circulation and money in reserve.

As gold is the only common measure of value in England, we shall speak of gold alone for the sake of simplicity of explanation.

For purposes of large comparison, such as of prices in one century and another, and with respect to things in constant demand, we can approximately determine average prices, which we may regard as the standards

Distinction of money in circulation and money in reserve.

CHAP. X. of the periods compared. These standards must depend on the quantity of gold in the intertrading world. It is in this sense that we shall speak of a general standard of prices in the following remarks.

Suppose that, at a given time, eighty millions of pounds is the quantity actually in circulation in Great Britain, *i.e.* that this is the quantity actually needed to effect the current exchanges at the existing prices, the general standard of which prices, depends upon the quantity of gold in the intertrading world. It is plain that if this quantity (needed to effect the current exchanges) were increased or diminished, other circumstances remaining unchanged, prices must rise or fall respectively. But it is equally evident that any alteration of the quantity of gold in the country used only for ornamental purposes can have no effect upon prices; and, similarly, any alteration of the quantity of hoarded money can have no effect upon prices; and, similarly (and this is an important link in the exposition), *temporarily hoarded money* has no effect upon prices, so long as it is hoarded.

Hoarded money has no effect upon prices.

We must here anticipate in some degree what will be more fully exhibited in the chapters on Banking and Currency.

There is always a certain quantity of money temporarily hoarded and principally in bankers' hands. This money does not immediately affect prices. It is from these 'reserves,' as we may name them, that money is

exported from the country. The diminution of these reserves is the immediate effect of exporting money; the swelling of these reserves is the immediate effect of importing money. We see that these reserves at times, increase without increasing the circulation, and in spite of the bankers' efforts to put the excess in circulation (see Note to page 66); proving, thereby, that the mere presence of available money and the desire to use it, do not necessarily suffice to put it in circulation and to raise prices. On the other hand, there are times when the reserves decrease without decreasing the circulation (see Note to page 66) proving that the mere diminution of the whole quantity of available money, as distinguished from the quantity in circulation, does not necessarily lower prices.

Export and import of money only immediately affects the reserves.

The reasonable conclusion from these facts, seems to be, that so long as the efflux or influx of gold from or to the country, only affect the reserves, they have no effect upon prices;—that it is current prices which ordinarily regulate the quantity of money in circulation; and not the available quantity of money which regulates the fluctuations of current prices;—and that the mere increase or decrease of money in reserves, does not necessarily have any general effect on prices.

How the quantity of money in circulation is determined.

Thus we cannot escape, on the one hand, the conclusion, that the general standard of price (as defined above) depends upon the quantity of gold in the inter-trading world; that is to say, that the principal reason

CHAP. X. why it now requires a pound's weight of gold to buy the same quantity of food, for instance, which an ounce of gold would have purchased three hundred years ago, is the generally greater abundance of gold. It seems equally evident, on the other hand, that the quantity in circulation as money in a given country at a given time depends upon the quantity needed to exchange goods at the prices previously established by the general quantity of gold and by the fluctuating abundance or scarcity of supply or demand of each article of exchange.

To state the foregoing in other words:—It seems that *the general quantity of gold in the intertrading world determines the general standard of prices*, and that *the standard of prices, modified by the fluctuations of general supply or demand* (*i.e.* modified by the fluctuating extent of exchange transactions), *determines the quantity in circulation as money.*

The point is so important and so commonly misconceived that we repeat the statement in a third form; *i.e.* that *prices are determined by the equation of a supply and demand which depend upon the relation of the quantity of the commodity used as money and the quantities of all other things seeking exchange by means of money; and the quantity actually in circulation as money, adjusts itself to those prices.*

The student in considering the foregoing proposition must beware of the fallacy of identifying the sign and

the thing signified, price and value. The general rise of prices in past times is no proof of change of values. The statement 'prices are determined,' &c., must not be mentally translated into 'values are determined,' &c. CHAP. X.

We spoke above, of the increase or decrease of the quantity of money in circulation or of *anything equivalent* thereto. The two things which may be equivalent, in effect, to an increase of money in circulation, are

Facilities of trading intercourse and credit.

Facilities of communication and credit are equivalent in their immediate effect to money in circulation.

Whatever facilitates intercommunication of traders, enables a given quantity of money to do more service than it otherwise would; and the effect is the same as of an increased quantity of money without such facilities. We may show this by supposing an extreme case as follows. If the several receipts and payments of a certain trader were equal, and simultaneous, and made in one place; he would not need to keep any money at all. What he desired to pay to one, would be provided at the same moment by some sum to be received by him. And even, if instead of supposing an absolute and impossible coincidence, we suppose the receipts and payments to be as nearly simultaneous as possible; it is evident that a very little credit, by enabling him to postpone payment to one until he should receive payment from another, would dispense with all need that he should keep money.

In actual fact, the several receipts and payments of each person, if hoarding be excluded, equal each other

CHAP. X. in the long run; but they are not equal within short periods; and they are not made all at one time and at one place. But, as respects the use of money, facilities of communication evidently approximate, in effect, to identity of place; and facilities of credit approximate, in effect, to equality of receipts and payments and identity of time; because credit enables the postponement of payments to the same time as receipts; and, also, in many cases, enables the adjustment of receipts and payments to be effected, the one by the other, without the actual transfer of money.

The foregoing observations may suffice to show how all facilities of trade make a given quantity of money do more work; and how credit does, in part, the work of money, making the actual quantity of money do more service than it would without that credit.

Documentary forms of credit, *i.e.* written acknowledgements of debt by one person to another, often still more nearly fulfil the function of money. The effect of credit on prices will receive further notice in a subsequent chapter.

Thus it will be understood that, the effect of a diminution (positive or relative) of the quantity of money, may be counteracted by facilities of trade making money do more service, and by forms of credit supplying in part the place of money. Similarly, a diminution of credit may counteract the tendency of an increased quantity of money to raise prices.

Summary of principal propositions.

The several propositions established in this chapter, are

1. Prices represent the relative value of the commodity used as money and all other things; and are determined, like every other value, by the equation of supply and demand.

2. The general standard of prices depends upon the quantity of the commodities used as money possessed by the intertrading world.

3. The temporary fluctuations of prices of particular things, depend upon the fluctuations of supply or demand of those things.

4. The general standard of prices, modified by the fluctuations in extent of exchange transactions, determines the quantity of money in circulation. (This proposition of course excludes the case of an inconvertible paper currency the acceptance of which is enforced by the State.)

5. Temporary increase or decrease of the quantity of money in a country does not affect prices, so long as it only affects the quantity of money in reserve, and not the quantity in circulation.

6. Facilities of communication and credit are equivalent, in their immediate operation, to an addition to the money in circulation.

CHAPTER XI.

INTEREST.

CHAP. XI. INTEREST is defined, by common use, to be *the price paid in money for the loan of the use of money.*

The nature of interest.

The use of money is the use of the capital which it commands or of the labour which that capital commands.

Speaking generally, the lenders of capital are those who, possessing capital, desire a profitable return from it without applying their own labour to its employment.

Two classes of borrowers.

We see that there are two classes of borrowers, those who borrow for profit, and those who borrow from necessity. The first class of borrowers are those who are willing to take the labour and risk of the employment of capital (or of directing its employment) for a return somewhat less than the whole profit. The second class of borrowers may be represented by Governments, who borrow for State necessities, and by all persons who borrow in order to meet previous engagements, *i.e.* in order to pay their debts. Common observation shows that the price of loans is determined like the value of anything else, by the bargaining of the market, *i.e.* by the result of the two forces of the demands

of buyers and sellers, in other words, by the equation of supply and demand. In some cases of pressing need to meet engagements, we see that the rate of interest may rise indefinitely. In the case of borrowers who borrow for profit, the difference between the full profit on the employment of the capital and the adequate inducement to incur the labour and risk of its employment, is, of course, the maximum price (the highest rate of interest) which the borrowers will pay.

How the rate of interest is determined.

The borrowers for profit cause the largest part of the constant demand for loans. There are occasionally enormous demands by Governments, especially to meet the great expenditure of war; but the largest *constant* demand is for purposes of profit.

By the constant law that abundance tends to low prices and scarcity to high prices, it is evident that, when capital is abundant, the price paid for the loan of it must be proportionally low; and when it is scarce, it must be proportionally high. Similarly, when money is plentiful or scarce, the rate of interest must be low and high respectively.

As money represents capital, it would seem inferable, from the foregoing propositions, that money offered on loan must be plentiful when capital is plentiful; and scarce when capital is scarce; and experience confirms this as the general rule. But sometimes we see the seeming anomaly of the rate of interest being low when capital is proved, by a comparative stagnation of trade,

Interest ordinarily high or low as capital is scarce or plentiful.

How interest may be low

CHAP. XI. to be scarce. The anomaly is only apparent not real.

when capital is scarce. The full explanation must be reserved for the chapters on Banking and Currency; but a sufficient present explanation may be given as follows.

To understand the matter, it is necessary, in the first place, to remember two different senses in which 'value of money' may be intended. One sense is the true value of money, viz. its purchasing power to purchase other things. The other sense is the price (interest) paid in money for the temporary use of money.

Effect of scarcity of capital on value of money. When capital is scarce, the true value of money, *if unchanged in quantity*, is diminished, inasmuch as it represents less capital. The tendency of current prices to rise may be, and usually is, counteracted by money being withdrawn from circulation, as explained in the foregoing chapter. But the value of all the *available* money (*i.e.* all in circulation and in reserves taken together), as a whole, must be less, unless there be a proportionate diminution in quantity by export; or unless the equivalent of such diminution takes place by diminution of credit. When capital becomes abundant, the value of the available money, as a whole, rises. If, therefore, we suppose an extreme case, as that a man should borrow money when its purchasing power was at its lowest, and should repay it when its purchasing power was, say, ten per cent. greater; it is evident that he would, in essential fact, pay ten per cent. interest, in addition to the agreed rate of interest paid in money. Thus it will be under-

How money may seem plentiful when capital is scarce.

stood how a deficiency of capital may cause a small demand for loans even at small rates of interest. Money in this sense may *seem* plentiful; whilst capital is really scarce. CHAP. XI.

The same phenomena may be exhibited in various ways. We showed, in the previous chapter, how the general standard of prices, modified by the fluctuations in extent of exchange transactions, regulates the quantity of money in circulation. Consequently when capital is scarce and exchange transactions few, less money is required in circulation; and so there may be large accumulation in the reserves. The reserves are the loan fund; and, thus, money *for loan* may be plentiful, when capital is scarce. The same consequence might be shown in other ways; and fuller explanation will be given in future chapters.

The effect of risk on interest.

Risk is an element on both sides, in the equation of the supply and demand of loans. The borrower's risk in the employment of capital, tends to diminish the interest which he can afford to pay. On the other hand, if the circumstances of the borrower or his intended use of the money, make repayment in any degree uncertain; the interest must be proportionately greater to induce the lender to give the loan.

Although there is no limit to the possible reduction of the rate of interest short of its extinction; yet experience shows that, in a given country, there exists for a considerable time, a certain average rate of interest for

CHAP. XI. loans in which risk is at a minimum. This rate may be, and often is, treated as an approximate standard, above and below which the temporary fluctuations take place.

An average or standard rate of interest determined by average rates of profit on capital.

We may consider what determines this average or standard rate. Evidently it must be determined by the average rates of profit on capital. The higher the rate of profit, the greater will be the inducement, and consequently the competition, to borrow capital, *i.e.* to borrow the money which commands the capital. The less the profit, the less the inducement. What determines the rate of profit, will be considered in a future chapter on 'Profits.'

Loss of interest is often spoken of when no loan of money or capital has been made. Thus, any delay in receipt of returns of produce from capital, is spoken of as loss of interest. It is well to explain this.

To state what has been already said, in other words, the existence of interest (paid for the sake of profit) depends upon the power of capital (in employment of labour) to more than produce itself, to produce in excess of its own equivalent. Interest represents the portion of that excess which others are willing to give to the owner of the capital, for the opportunity of appropriating the remainder of the excess. Therefore, what is lost by delay in employing capital, or by unusual delay in obtaining the produce of any particular employment of it, is the excess beyond its own quantity which it might (by loan) have been made to produce to the owner, even

Delay in obtaining return of capital, an element in cost of production.

without the owner's labour, during the time of delay. This is conveniently and truly represented as loss of interest. CHAP. XI.

From the foregoing it is evident that delay in return of capital, is an element in the comparative cost of production.

We sometimes see calculations that a given sum at compound interest, would amount, in a few hundred years, to some sum of money exceeding all the gold in the world. The calculation would correspond with fact up to a certain point. It may be useful to show the limits of accumulation by interest, and the fallacy of such calculations of enormous accumulation.

Nature and limits of accumulation by compound interest.

It must be observed in the first place, that increase by interest, has no meaning in relation to the general quantity of wealth. Production cannot be increased by interest. Interest can only affect the *appropriation* of the produce. Increase by interest can only mean the increase of some share in the produce, which must equivalently decrease some other share or shares.

Accumulation by interest is accumulated appropriation of capital paid for the loan of capital. This accumulated appropriation cannot exceed the surplus produce of a community, after sustenance of the whole community and after appropriation by the borrowers of their share of the produce. This is one mode of stating the absolute limit to accumulation by interest. Within this limit, a single person or any section of a community,

CHAP. XI. may, conceivably, appropriate by interest any portion of the surplus produce (although of course there are, practically, much narrower limits).

Again, as respects accumulation of interest calculated in money; the value of the money is the value of the capital which it commands. Consequently, no increase of the figurative sum which commands the whole existing capital, can represent a greater value than that whole. Moreover, no one can borrow to an indefinite extent, and, so, pay interest to an indefinite amount, unless the capital which the borrowed money represents, be employed reproductively. The more capital is produced, the more plentiful does it become; and, consequently, the lower is the price paid for the use of it. In this last circumstance consists the special fallacy of such calculations of enormous accumulation by interest, as above noticed. As accumulation of capital increases, the rate of interest must decrease; and, consequently, the supposition that a given rate of interest could endure throughout an enormous accumulation, is false.

Summary of principal propositions.

The principal propositions established in this chapter are

1. The rates of interest at any given time are determined, like any other price, by the equation of the supply and demand of loans; modified, in the various instances, by difference of risk and of other circumstances of relative needs of lenders and borrowers.

2. So far as there exists a recognisable average or

standard rate of interest, it depends upon the average rate of profit. CHAP. XI.

3. Delay in employing capital, or delay in obtaining the produce of any particular employment of capital, is equivalent to loss of interest on the capital during such delay.

4. Interest on the capital employed, and for the time occupied, in production, is an element in the cost of production.

5. Increase by interest is only an increase of some share in the produce of capital which must equivalently decrease some other share or shares.

6. As accumulation of capital increases, the rate of interest decreases; and this limits the possible accumulation of anyone's share by compound interest.

CHAPTER XII.

WAGES.

CHAP. XII.

Definition of wages.

WAGES are *the price of labour*, and are determined as observation shows, like the price of anything else, by the equation of supply and demand.

The cost of production of labour.

The cost of production of labour evidently includes not only the present sustenance of the labourer, but the cost of qualifying him for the labour, whether that qualification be only growth to manhood or the costly acquirement of some special skill in addition. We see that cost of production does not place the same limit to the fall of the price of some kinds of labour, as it does to the fall of price of other things; because other motives than obtaining wealth, induce such competition for some kinds of employment, that the wages of those employments do not in some cases even equal the cost of maintenance. This is the case, for instance, at present in England with respect to many clergymen and officers of the Army and Navy and other officers of Government. But the great mass of labourers depend wholly upon wages for sustenance; and, in their case, the cost of

production may be regarded as determining a minimum rate of wages which can endure.

Increase of supply of any labour beyond increase of demand keeps wages at a minimum.

Demand for a given kind of labour, of course corresponds with the demand for the produce of that labour. The natural increase of population may increase the supply of some kind of labour independently of an increased demand, in which case we cannot doubt that wages must fall or be retained at a minimum, until supply and demand are equalised either by fall of wages causing increased demand or by diminished supply of labour in consequence of the labourers seeking other work. Agricultural labour wages were apparently at a minimum in some parts of England for many years on this account.

Increase of demand beyond increase of supply of labour, must raise wages.

Conversely, if the supply of a given kind of labour be diminished or do not readily increase in proportion to an increased demand, wages must rise until supply and demand be equalised. The labour of skilled artisans generally, affords example of this in past years in England.

In saying that wages *must* rise or fall, we speak of what is inevitable if the inequality of supply and demand endure for some time. In many kinds of work a certain standard of wages obtains a traditionary acceptance which prevents response to temporary fluctuations. Such traditionary standards vary in strength of resistance to change amongst different peoples and in different trades.

Explanation of the notion of a

Wages, though paid in money, are virtually paid out of surplus capital, *i.e.* the capital which at any given

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wages fund.

time, being in excess of all immediate requirements, is devoted to production, and is, therefore, spent as wages. Consequently, it is often assumed that although the difference of wages in different employments, depends upon the equation of supply and demand in each employment; yet that demand for labour on the whole will be greater or less, and wages, therefore, greater or less, as the surplus is greater or less. The surplus is, on this account, sometimes named the 'wages fund.' This would be true in an isolated country. But foreign trade modifies this conception of a wages fund. The surplus capital may, and in England largely does, go to employ labour in other countries. It is true that the profits of such foreign employment of capital, return to the original owners of the surplus; but these may again send the profits abroad; and so on indefinitely. The consequence might *conceivably* be that the constantly increasing wealth should be employed to support a constantly increasing class of capitalists, whilst the wages of ordinary productive labour remained unaltered. But we see that, in fact, the attractions, conveniences and responsibilities of propinquity, do, and must always, prevent the exclusive transference of increasing capital to other countries; and the inference seems inevitable that wages on the whole cannot remain unincreased by increasing profits, excepting by reason of the competition of an increasing number of labourers.

Increase of wages must follow increase of profits, unless counteracted by increase of labour.

The case of an isolated country is always important

to consider, because it exemplifies the tendencies as respects the intertrading world as a whole. The surplus capital is truly the wages fund of the whole world; and it is true that the larger the unreproductive expenditure of the surplus, the less will the succeeding surplus (wages fund) be.

Important considerations attach to the foregoing propositions, which will be treated under the head 'Distribution of Wealth.'

In treating, as above, the minimum enduring rate of wages of the ordinary labouring class, as corresponding with the cost of sustenance of the labourer, it must be remembered that experience shows such sustenance to be a quantity varying at different times in different countries, in different parts of the same country and in different occupations. This standard of bare sustenance (*i.e.* the lowest point to which wages can be reduced, beyond which point the labourers would emigrate or throw themselves on charity or proceed to violence or adopt some course other than quiet acceptance of a lower rate of wages) has important bearing on the well-being of a community, as will be more particularly considered hereafter. It is here noted only as a fact recognisable by experience, that at any given time there is such a standard of minimum sustenance or minimum wages, which is not absolutely determined by physical possibilities; but varies in different times, countries and employments. The pressure of necessity may gradually

The existence of a standard of minimum wages.

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lower it, as favourable conditions may gradually raise it; but at any given time such minimum exists.

Wages not identical with cost of labour.

The rate of wages must not be identified with the cost of labour to the capitalist. If one labourer can do much more effective work than another; the labour of the one may be less costly, though he receive higher wages than the other.

Further important considerations touching wages, especially in their relation to the capitalist's profits, will be treated in future chapters on 'The Distribution of Wealth' and on 'Co-operation.'

Summary of principal propositions.

The principal propositions exhibited in this chapter are

1. The rate of wages is determined by the equation of supply and demand of labour for each kind of work.
2. The cost of production of labour includes not only the present sustenance of the labourer but the cost of qualifying him for the labour; whether that qualification be only growth to manhood or the costly acquirement of some special skill in addition.
3. The standard of 'sustenance' varies in different countries, in different occupations and at different periods.
4. As the surplus produce is spent in production, such surplus in an isolated country would form the wages fund; and wages would, on the whole, be higher or lower as such surplus might be greater or

less. But, in actual fact, the power of sending capital to be employed in other countries, prevents such an immediate relation between the gross profits of capital and the gross expenditure on wages in a given country.

5. The rate of wages does not correctly represent the cost of labour to the capitalist, because of the varying efficiency of the same kind of labour.

CHAPTER XIII.

RENT.

CHAP. XIII.

RENT is defined by perfectly consistent common use to be *the price paid for the use of fixed capital or of exclusively appropriated natural agents*, of which land is the principal.

Definition of rent.

This perfectly consistent use by all but a few writers of scientific treatises, is sufficient objection to the restricted sense in which the word is used by those writers.[1]

[1] Ricardo and Mill, for instance, treat of rent as the price of exclusively appropriated land only, to the exclusion of the price for the use of fixed capital. Ricardo restricts it still further to the use of 'the original and indestructible powers of the land,' to the exclusion not only of farm buildings but of such improvements as drainage and fencing. (*Principles of Political Economy and Taxation*, 2nd edition, pages 48 and 50.) Even if this restricted use of the word be accepted, the theory of rent founded on it by those writers, is confessedly inapplicable to all kinds of rent of land. Mill, in one place, describes the theory as follows: 'The rent which any land will yield, is the excess of its produce beyond what would be returned to the same capital if employed on the worst land in cultivation;' and he adds: 'This is not, and never was pretended to be, the limit of metayer rents or cottiers' rents; but it is the limits of farmers' rents.' (*Principles of Political Economy*, Book II., Chap. XVI., § 3.)

We object therefore to the restricted definition of the term, as being inconsistent with universal common use; and to the theory founded thereon for the additional reason that it is too narrow. We require a theory of rent which will apply to all cases of rent.

How rent is determined.

Common experience shows rent to be determined, like the price of anything else, by the equation of supply and demand.

Minimum rent of fixed capital.

The necessary cost of use of fixed capital, is evidently (see Chap. VII. and Chap. XI. Props. 3 and 4) the interest on the cost of producing the fixed capital added to the constant cost of maintenance; and this must be the minimum rent of fixed capital which can repay the outlay.

As respects rent of land, it is to be observed that exclusive appropriation is a necessary condition of rent as of any other price. Land is absolutely indispensable for the sustenance of the community; and, consequently, those who have the control of it, can effectively demand a price for its use; which price is determined like every other price by the equation of supply and demand.

The maximum rent of land.

The maximum rent which can endure, is, evidently, the value of the produce in excess of the cost of production.

It was shewn (Chap. IX. Prop. 7) that if one kind of produce be produced under various conditions, so that under some the cost of production is less than under others; the value of the whole tends to, and cannot permanently be less than, the cost of production of the most costly part. Agricultural produce is eminently of this character because of the varying fertility of land; and, so, the value of the whole necessarily exceeds the cost of production of the whole; and all who produce at less than the greatest cost, can pay the difference as rent.

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The rent of land does not affect the value of agricultural produce.

Although, as stated above, the exclusive appropriation of land enables the holders of it to exact a rent for its use; yet, it was shown (Chap. IX. Prop. 6) that monopoly can raise the value of any produce only by restriction of the supply. It follows that the holders of land have no power to raise the value of the produce; and, consequently, have no power to raise the rent indefinitely, so long as they do not restrict supply. Although, in some instances, the exclusive appropriation of land leads to withdrawal of the land from cultivation; and so far tends to raise the value of the produce; yet we see that, speaking generally, the consequence of appropriation is not to diminish production. Consequently *the appropriation of the land does not affect the value of the produce. It only affects the distribution of the value between the cultivators and landowners.* The high value of the produce is not caused by rent; but rent is caused by the high value of the produce in excess of cost of production on the whole. Consequently *rent of land is not part of the cost of production of agricultural produce.* This agrees with the similar inference in Chap. VII., deduced from the fact that the payment of rent involves no direct or necessary additional consumption of capital.

The foregoing proposition is evidently of great social importance. The erroneous belief that the rent raises the value of the produce, is a source of much mischievous though groundless ill-feeling.

CHAP. XIII.

Summary of principal propositions.

The principal propositions established in this chapter, are

1. Rent is determined like any other value or price, by equation of supply and demand.
2. The necessary cost of use of fixed capital is the interest on the cost of producing the fixed capital added to the constant cost of maintenance; and this must be the minimum rent which can repay the outlay in providing the fixed capital.
3. The maximum rent of land which can endure, is the difference between the value of the produce and the cost of production.
4. Rent of land does not affect the value of agricultural produce unless the exclusive appropriation of the land be so used as to restrict the quantity of produce.

CHAPTER XIV.

PROFITS.

CHAP. XIV.

PROFIT is defined, by common use, to be *the value of produce in excess of the cost of production.*

Definition and nature of profit.

A thing may be produced by a workman who provides both the labour and the necessary capital, as in the case of many small handicrafts. In such case, there is no formal element of wages; and the whole profit is received by the workman. But the greater part of the productive industry of this country, is conducted under conditions which require the provision of a large amount of capital; and the majority of the workmen receive their remuneration as wages paid by those who provide the capital (the employers or capitalists); and these wages being part of the cost of production, the whole profit (the value in excess of that cost) is received by the capitalists. Therefore *profit is the remuneration of the capitalist.*

Profit must, ordinarily, be in excess of interest; because it is only the hope to receive that excess, which ordinarily induces the use of capital for profit.

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The excess of profits over interest, may be regarded as wages of the capitalist's labour in management (or in whatever part he takes in production), and compensation for risk (equivalent to 'insurance').

Elements of profit.

Profit may, therefore, be regarded as consisting of three elements,—Interest on the capital employed, wages of the capitalist's own labour, and insurance.

Tendency of profits to equality of rate.

Competition of capitalists must have a tendency to equalise profits; because any inequality, other circumstances being the same, would attract competition to the trade which gives the higher profits (Chap. II. Prop. 15); and this competition would lower those profits.

Causes of differences of rates of profit.

But, although profits may *tend* to an equal rate, there are permanent differences of circumstances in different trades, which must permanently maintain large inequalities of rates of profit. The principal differences are differences of risk, of time between the expenditure of capital and its return, and of comparative attractiveness and repulsiveness of the trades. The practicable extent of a business is another subject of difference which causes unequal rates of profit; because the rate of profit sufficient to induce a capitalist to employ his capital in meeting a small demand (as for instance in the retail trade of a small community), must be greater than to meet a large demand from which the *aggregate* profit may be very large although the *rate* of profit may be small.

The minimum rate of profit which can endure, is,

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evidently, the lowest rate which would, under any circumstances, induce people to spend capital reproductively, instead of employing it to provide luxuries for themselves. In this sense, there is no absolute minimum short of the extinction of profit.

The minimum rate of profit.

There is, however, a practical minimum rate of profit at any given time, in the sense that it is the least which actually *does* attract the employment of capital for profit. This evidently depends upon the intensity of the desire to accumulate and the degree of risk attending the processes. The desire and the risks vary according to the character and circumstances of different communities and different periods; and, at any given time, they vary according to the character and circumstances of different persons and occupations. Nevertheless, it is a reasonable inference that there is, at any given time, in a given country, a certain rate of profit, less than which would not, at that time, generally attract the employment of capital for profit. (We say 'attract,' because when capital has been largely spent in some particular employment, it is often preferable to continue expenditure thereon rather than to sacrifice all the previous expenditure, although the rate of profit be not such as would attract fresh capital to the business.)

The question of what would happen if profits generally should fall below this minimum, has considerable significance in relation to the distribution of wealth; and will be here considered.

Let us suppose a community in which a certain rate of profit is the minimum effective inducement to the general employment of capital for profit; and let us further suppose that circumstances should so increase the cost of production[1] or diminish the value of the produce, as to cause the rate of profit to fall below that minimum. What would happen? Capitalists by the hypothesis would have no sufficient inducement to employ their capital reproductively. What are they to do with it? Until they could make labour more effective (so raising the rate of profit again by diminishing the cost of production), or could find some new employment for capital (which by creating a new demand for its produce would raise the rate of profit by increasing the value of the produce); they could only employ it unreproductively in providing luxuries for themselves, or waste it.

The consequence of profits approaching the minimum rate.

Either waste or unreproductive expenditure diminishes produce = increased value of produce = increase of the rate of profit. Thus it appears that the falling below a certain minimum rate of sufficient inducement, would, *ipso facto*, raise the rate of profit again. It may be assumed that this would be foreseen and anticipated; and that any near approach to the minimum would lead to capital being spent in the ways above mentioned.

[1] Increased cost of production must be due either to more labour being required for a given result or to higher wages. More labour may be necessary in consequence of the exhaustion of the least costly means of supply; as, for instance, would happen if it should be necessary to dig much deeper for coal than hitherto.

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Actual experience confirms this inference. Experience shows that as profits decrease, the desire to obtain the accustomed rate of profit, leads to new modes of employing capital reproductively; especially to new modes of diminishing cost of production; and to employment of it in foreign countries where profits are higher. The inexperience of the new modes, and the competition to share in the higher profits expected from them, leads often to great waste; so that waste, though unintentionally, is, in fact, a not inconsiderable means of checking the fall of the rate of profits.

The foregoing propositions imply (as indicated at the beginning of the chapter), the supposition of the greater part of the employed capital being supplied by one class of persons and the labour by another class; because the distinction of profits and wages depends upon the separation of the classes 'capitalists' and 'labourers.' But, to some extent, the same persons supply both capital and labour; and, in the future, this may be the case to a very much larger extent. It is abstractedly conceivable that thus, the distinction of profits and wages might be extinguished; because if capital and labour were generally supplied by the same persons, the division of the produce as profits and wages, would cease to have any meaning.

Summary of principal propositions

The principal propositions established in this chapter, are

1. Profit (the value of produce in excess of the cost of

production) is the remuneration of the capitalist for devoting his capital to reproductive purposes.

2. Profit may be regarded as comprising interest (on the capital for the time occupied in production), insurance (compensation for risk) and wages for the capitalist's own labour.

sitions in the chapter.

3. Competition of capitalists *tends* to equality of rates of profit; although the tendency is counteracted by permanent differences of circumstances of different trades.

4. At any given time there exists, though indefinably, a certain rate of profit which is the minimum which induces the general employment of capital reproductively; and if profits should fall below that minimum, the fall would cause a reaction to a higher rate.

5. As capital increases and the rate of profit decreases, the general attainment of the minimum rate of profit is, in fact, prevented by employing capital on means of diminishing the cost of production, and by sending capital to foreign countries; and the increase of capital is also much checked by waste attending new speculative modes of employing it.

CHAPTER XV.

CREDIT.

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Definition of credit.

CREDIT, in connection with the subject matter of political economy, always means, in effect, *power to borrow capital.* The phrase 'giving credit' ordinarily conveys the idea of trusting another to pay a due sum at a future day. But the dealer who trusts his customer to pay at a future day, does, in fact, give the customer power to borrow the dealer's capital for just so long as the customer delays payment. Again, we hear of one person lending his credit to another, when there is no necessary transfer of capital between them; and the one has only given security for payments due by the other. But such security means that, in a certain case, the capital of the one will be available to pay the debt of the other; and this is equivalent to giving power to the latter to borrow the capital of the first. It is probably unnecessary to exemplify further the accuracy of the definition.

Credit more or less as

Credit being power to borrow capital, derived only from readiness to lend it, it is inferable from Chap. II.

Prop. 13, that credit will be generally larger as capital becomes more abundant; and less as capital becomes less; and this corresponds with notorious experience.

capital is more or less.

Credit has a large effect in promoting trade. It is evident that it cannot directly increase the quantity of capital, or the quantity or efficiency of labour, or of natural agents. It cannot, therefore, directly increase the quantity of produce. But it indirectly increases the effectiveness of capital and labour by facilitating the transfer of capital to the hands of those who can use it most effectively. This may be exhibited elementarily as follows:—Suppose that there were no credit, *i.e.* that no one would lend capital. Many would be unable to direct the employment of all their own capital in any way. They would be restricted to its uses in places near at hand, in employments which they understand, and they would be restricted by the time they could spare for supervision. The waste in such a case is obvious. The introduction of credit enables a man who, for one reason or another, could do little with his capital, to lend it to others who have facilities for its use. This effect of credit to make labour and capital more effective is plain.

The operation of credit to facilitate trade.

But in countries in which trade is highly developed, credit takes a range beyond the mere transfer of capital to the most effective hands, and has an effect different in kind from that of making capital more effective.

For simplicity of illustration, let us suppose a trading

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Illustration of effect of large development of credit.

community represented by three persons A, B, and C. A is a holder of capital who only lends it at interest. B is a holder of capital who directs some kind of trade. C is a holder of capital who directs some other kind of trade. The stock of capital possessed by each may be represented by the number 1,000. We may, further, suppose that credit has effected the most convenient distribution of capital; and that that distribution is as follows:

A has lent all his capital to B at interest.

B employs all his own and A's in his trade.

C employs all his own in his trade.

B expects a profit on his trade. If he does not get it, he alone is disappointed. If he actually incur a loss, that loss is the whole loss either to himself or to the community. But suppose that B, in consequence of the large *expected* profits of his business, desires to borrow additional capital wherewith to extend his business; and suppose that, although C eventually requires all his own capital in his own business, yet he can spare half of it for six months; and that, as B expects a return to his capital within six months, C lends 500 to B for that period. If within six months, it replaces itself in B's hands, and is repaid to C, all goes well. B and C and the whole community have been benefited. B by greater profit, C by interest on 500 for six months, and the community by greater production. But suppose, on the other hand, that B's business is not so successful

as expected; and that at the end of the six months the expected returns have not come in. C wants his capital back for his own business. B cannot pay it; and two productive businesses are wrecked by the loss attending one, because the same capital was pledged to two businesses. The same capital was not spent in two businesses; that is impossible. But the credit given by C to B pledged the same capital to two businesses. Or, to state the same fact in another manner, B pledged future and therefore uncertain capital. C, also, in carrying on his business in reliance on B repaying him, equally pledged future and therefore uncertain capital.

We have only to imagine the development of this fictitiously simple case, to more numerous and complicated inter-relations of credit, in order to perceive that it shows elementarily

1st. How credit may enormously stimulate trade.

2nd. How credit, in so doing, may, possibly, as, in fact, from time to time, it does, cause very wide-spread loss throughout the trading community.

Effect of credit on prices.

It was shown (Chap. X. Prop. 6) how credit performs the function of money; and, consequently, if all other circumstances be unchanged, it must raise prices (Chap. X. passim). This may be shown in another manner. Credit being a borrowing power is, in effect, a purchasing power. In fact it often appears simply as a purchasing power without any previous formal process of borrowing; as when any well-known man goes into the

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market, and purchases on his own credit (his own recognised power of borrowing) without immediate payment. The purchases made by credit increase demand just as much as purchases made by payment of ready money; and increased demand raises price (Chap. II. Prop. 13). But although it is true that credit must raise prices *if* all other circumstances be unchanged; yet the effect of credit may be only to make less money needful; and so, instead of raising prices, to diminish the quantity of money in circulation; and, so, it may have no effect on prices.

So far as credit, by performing the function of money, diminishes the quantity of money in use, it frees a portion of the valuable commodity used as money, for use as a general commodity. Such release of gold or silver from use as money, is evidently equivalent to so much additional capital; because it is always exchangeable for additional capital in foreign countries.

Summary of principal propositions in the chapter.

The principal propositions established in this chapter, are

1. Credit makes labour and capital more effective by facilitating the transfer of capital to the most effective hands.
2. So far as credit enables traders to increase their operations by pledging future and uncertain capital, it greatly increases the losses and difficulties which attend adverse circumstances in trade.

3. Credit employed as a purchasing power, if all other circumstances remain unchanged, raises prices.
4. Credit, instead of raising prices, may be merely a substitute for a portion of the money which would otherwise be in circulation.
5. Credit increases the capital of a country in so far as it diminishes the quantity of the precious metals in use as money.
6. Increase of capital causes increase of credit; and decrease of capital causes decrease of credit.

CHAPTER XVI.

FURTHER CONSIDERATIONS REGARDING MONEY.

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Money in excess of what is needed for convenience of exchange, useless to an isolated community.

How the foregoing is affected by foreign trade.

IN the fictitious case of a perfectly isolated community, it is evidently useless to have more money than is needful in order to effect, conveniently, all its exchanges; because any additional quantity would only cause a general rise of prices (Chapter X. Props. 2 and 5); and the wealth of the community would be unaltered.

But, in the actual case of existing intertrading nations, the possession by one of more or less of the gold or silver which performs the function of international money, has the same significance in relation to the whole intertrading world, as the possession of more or less money by a single person has in relation to the rest of his community. The single person is only potentially, not actually, advantaged, unless he spend it. The rich miser lives in poverty because he does not spend his hoard. It would be the same with a nation. The possession, by one nation, of more money than is needful as a medium of internal exchanges, is only an advantage by its being used for other purposes than money or to purchase other things from foreign countries.

Credit not only conveniences the trading community by avoiding the trouble of carrying about large quantities of money; but it releases a part of the international money which would, otherwise, be needed for internal exchanges; and this money, so released, can be used for other purposes than money or profitably employed in foreign trade.

An increased quantity of money throughout the world useless on certain suppositions.

As, in the matter of the possession of money, the relation of a single nation to the rest of the world, is analogous to that of a single person to the rest of his community; so, the total quantity of money in the intertrading world, affects that whole world in a manner analogous to that in which the total quantity of money in an isolated community affects that community. It is, in an elementary sense, true, that all intertrading nations, regarded as one community, are not advantaged by an increase of money beyond what is needed for convenient exchange. It is not, therefore, meant that an increased supply of gold or silver is of no advantage. The whole world is yet far from having the full quantity demanded for convenience as money; and, irrespectively of their use as money, gold and silver are so eminently useful in manifold ways, that, as the increased supply is not likely ever to make so sudden and large a decrease of their purchasing power, as would seriously disturb the just relations of debtors and creditors; it is not probable that we shall ever reach a point at which a further supply of gold or silver would be mischievous or useless. It is,

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nevertheless, evident that, if gold and silver were not useful for any purpose but money, there is a conceivable point at which an increased supply would be useless; because only raising prices, without increasing the wealth or convenience of the world in any manner.

The sense in which money is spent.

With the foregoing explanations in mind, we may consider what is the essential meaning of spending money. The money is not consumed. No one supposes money to be spent by transferring it from one pocket to another. Similarly, if one person freely give money to another; the community to which they both belong, is neither richer nor poorer. The money has not been spent. It is only the right to spend it which has been transferred from the one person to the other. Hence it has often been supposed that money is not spent by a nation or community, if it only pass between members of that community; and that, consequently, money paid to foreigners, involves a greater cost to the community than the same sum paid to one of its own people.

Spending money, means spending the capital and labour which money represents and commands. The transaction of giving freely a sum of money to another person, is attended by no expenditure of labour or capital. But if one gives a sovereign to a tailor for a coat; the real expenditure is of the labour and capital expended in making the coat. It may be said that this expenditure took place before the purchase; and how can the purchase cause it? The answer is, that the coat

was only made because of the probability of obtaining a sovereign for it, *i.e.* of obtaining for it the command of so much capital or labour as the sovereign represents. The payment, therefore, of the sovereign, as truly induced the expenditure of so much capital and labour in making the coat as if it had been paid in advance for the express purpose.

Relative effect of purchasing in home and foreign markets.

If the coat be purchased abroad; the money payment transfers to a foreigner the command of so much capital or labour; but at the same time the home community is saved the equivalent expenditure of labour and capital in making the coat; and, consequently, if the community has other equally useful ways of employing its capital and labour; it has neither lost nor gained by the purchase of the coat abroad instead of at home. If the foreigner is able, by some means, to make the coat at less cost than that of the home manufacture; the community, on the whole, has gained by the purchase being made abroad. By similar reasoning, the community, of course, would lose by purchasing abroad what it could make more cheaply[1] at home. Money is in

[1] The condition of making 'more cheaply,' must be understood in relation to the value, not the quantity of labour. A skilful cabinet-maker might be able to do a piece of rough carpenter's work with less labour than an ordinary carpenter; and yet it would be cheaper to him to employ the other to do the rough work, because his own labour would be more advantageously employed on something else. In this sense, a nation often imports from abroad what it could make with as little labour as is expended by the foreigner in providing it; because the home labour has more profitable occupation.

Of course the quicker return of capital ordinarily obtainable by expen-

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fact, as previously shown (Chap. V. Prop. 5), the representative of capital. Price in money, represents general exchange value; and general exchange value must have reference to general needs. The general need is for that which will command labour or the produce of labour, *i.e.* capital.

Further consideration of the relation of money and capital.

Seeing that money is the representative of capital; and that its value depends on the quantity of capital which it represents; and knowing that its function is the exchange of commodities and the measure of value; and that, as shown in Chapter X., the quantity of money (or whatever acts as money) in *circulation* is determined by the general standard of prices and the extent of exchange transactions; we may make some important inferences, which are confirmed by experience.

The means by which the quantity of money in circulation (or its equivalent) is diminished or increased are obvious. Gold and silver are money of the intertrading world. Consequently if the capital in any one country be diminished; the gold or silver money in circulation in that country, if unchanged in quantity, becoming of less value (as representing less capital) can be sent to some other country where it would represent more capital and be of more value. Diminution of credit, moreover, is equivalent, in its effect on prices, to diminution of money in circulation; and temporary hoarding

diture at home, is an element in the comparative cost (Chap. XI. Prop. 4); as also is the cost of transmission.

has the same effect. For instance, a temporary diminution of capital by a deficient harvest, is usually attended by an export of money to purchase food; and a temporary diminution by any wasteful form of over-trading, is always attended by diminution of credit.

Similarly if the capital in any one country be increased; money in that country, if unchanged in quantity, would become more valuable; and additional money may be brought into circulation, either from temporary hoards or from abroad; and the increase of capital increases credit, which is equivalent to more money in circulation.

Thus it happens that, although there is no fixed relation of quantities of money and capital; yet, under free conditions, money increases in any country as capital increases; and decreases with the decrease.

The foregoing propositions may be converted as follows.

1. If the capital in any country be diminished, the things performing the function of money within that country, if unchanged in quantity, must fall in value; and so far as that tendency goes beyond the diminution of credit, to the depreciation of gold and silver money (*i.e.* things which are equally available as money in other countries); it tends to cause the gold or silver money to be either hoarded or sent out of the country.

2. If the capital in any country be increased, the things performing the function of money within that country, if unchanged in quantity, rise in value; and,

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so far as that tendency goes, beyond the increase of credit, to an enhanced value of gold or silver money; it tends to cause gold or silver to be brought out of hoards or to flow into that country from abroad.

3. As the capital, in any country, increases and decreases, the quantity of things performing the function of money in that country increases and decreases; although not in any fixed ratio.

The importance of these propositions will be shown hereafter in treating of trade and currency.

Character of saving and hoarding.

There is one common error about spending money, which may be fitly noticed in this place. Because money is useless unless spent, and because all expenditure of money gives employment to labour; it is often hastily inferred, that a rich man benefits society more by even the most prodigal expenditure on mere luxury, than by not spending it at all. The fundamental fallacy is plain, so soon as stated. Excepting the case, now very rare amongst the wealthy, of a man hoarding his money in his own house; the man who does not spend his money, must lend it to some one else to spend. It is true that if he invests it in permanent securities or puts it in a bank; he does not think of it as lent; and it would not, ordinarily, be described as a loan of his money; but it is not the less truly a loan. If he should invest it, say, in the State loans; he takes the place of some former lender to the State; and releases an equal quantity of capital to be spent by some one else. If he put it in a

bank; he lends it to the bank; and the bank lends a great part of it to others who actually spend it. But being, in such case, always, in intention at least, spent reproductively; the depositor can recall the sum whenever he pleases; and, so, regards it as if it were merely locked in the bank's coffers for security.

It is plain, therefore, that in the above case, a man, by saving his money, will increase the wealth of the whole community, by just so much as his money will be more surely spent reproductively in the hands of bankers or by other investment, than if spent by himself. And on the supposition that if he had not saved the money, he would have spent it all in luxuries (unreproductively); the community is the wealthier by the whole value of the money saved.

Even in the case of hoarding, so that no one can use the money, there would be no comparative advantage *in respect of increase of production and wealth* in spending it in luxury. The money so hoarded is a command of capital; and it is evident that society can be none the wealthier by an equivalent quantity of capital being spent unreproductively.

We may, fitly, consider in this place, the exact character of hoarding (keeping money in such a manner that no one has any use of it).

Hoarding of money (regarded merely as money) is not a hoarding of capital. In the case of an inconvertible paper currency, the community is not the poorer

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by anyone hoarding such money. The hoarder, who might obtain interest for it, or might employ, profitably, the capital which it commands, is wastefully neglectful of his own means of acquiring wealth. But the only general tendency of hoarding such money, would be to increase the value of the money by diminishing its quantity (Chap. II. Prop. 14); and this would not affect the general wealth of the community.

Hoarding of money which has an intrinsic value and an international use, is wasteful in two other respects.

So far as money has an international use, the hoarding it, is a wasteful neglect of the means of wealth of one community, exactly analogous to the waste of the means of one person in the case of hoarding money which has not an international use. The gold or silver so hoarded, would have given a profitable command of the labour or capital of other countries; as the hoarded paper money would have given to the individual hoarder a profitable command of his neighbour's labour or capital.

So far as hoarded money has an intrinsic value, there is a general waste affecting the whole intertrading world, in the unnecessary withdrawal of a useful commodity from general use.

Summary of principal propositions.

The propositions established by this chapter, are as follows.

1. Money in excess of what is needful for mere convenience of exchange, is useless to an isolated community.

2. To a nation having foreign trade, money in excess of what is needful for internal exchanges, if of a kind used as money by other nations, is useful for foreign trade.
3. Credit being, in its immediate operation, equivalent to more money, is profitable by freeing actual money for use in foreign trade.
4. Viewing the whole intertrading world as one community, there would be no advantage in a general increase of the quantity of money (merely as money) beyond what is needed for convenience of exchange.
5. Money is only spent when it causes the expenditure of the capital or labour which it commands and represents.
6. If money be used to purchase from a foreign country, *i.e.* to cause production abroad instead of at home; such use only modifies the general wealth of the purchasing community, in so far as the production abroad is attended by an expenditure of labour and capital of more or less value than would attend the same production at home. If it be attended by an expenditure of more value, the general wealth is diminished; if of less, it is increased.
7. If the capital in any country be diminished, the things performing the function of money within that country, if unchanged in quantity, must fall in value; and, so far as that tendency goes beyond the diminu-

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tion of credit, to the depreciation of gold or silver money, it tends to cause the gold or silver money to be either hoarded or sent out of the country.

8. If the capital in any country be increased, the things performing the function of money within that country, if unchanged in quantity, must rise in value; and so far as that tendency goes beyond the increase of credit, to an enhanced value of gold or silver money, it tends to cause gold or silver to be brought out of hoards or to flow into that country from abroad.

9. As the capital, in any country, increases and decreases; the quantity of things performing the function of money in that country, increases and decreases, though not in any fixed ratio.

10. Money saved (in the ordinary sense) is not hoarded if it be lent or placed in a bank. On the contrary, such saving really ensures the employment of the greater part of it in reproductive ways.

11. Hoarding of money which has no intrinsic value or international use, is only wasteful to the hoarder.

12. Hoarding of money which has an international use, is wasteful to the community in which it is hoarded, by neglect of the profitable command of the labour or capital of other communities which it could give.

13. Hoarding of money which has an intrinsic value is wasteful to the whole intertrading world, by unnecessary withdrawal of a useful commodity from use.

CHAPTER XVII.

THE USE OF PAPER MONEY.

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Explanation of need for using a valuable commodity for a great part of the money of the world.

IT was shown in Chap. IV. Prop. 2, that intrinsic value is not an absolutely essential condition of money. But experience shows that, for incidental reasons, it is necessary that a large part of the money of the world should be something which, irrespectively of coinage, has an exchange value equal to its exchange value as money. The reasons which make this necessary, are first that, otherwise, in the present condition of the world, it would be impossible to prevent unlimited forged increase of money, *i.e.* it would be impossible to maintain the limitation of quantity which is a necessary element in the nature of money. Secondly, that because the needful quantity of money increases as trade increases; the problem of how the whole world should agree to regulate that needful increase, would be, practically, insolvable by any other means than the use of a commodity whose exchange value is regulated by what may be called the natural operation of supply and demand. Nevertheless, a large quantity of money is in

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use, which has not an intrinsic value nearly equal to its exchange value as money. We have to consider this fact.

In some cases, the money has a considerable intrinsic value although not equal to its exchange value as money. The English subsidiary silver coinage is an instance. The reason for this will be explained presently. For illustration of principles, we will first consider the case of paper money, which may be said to have no intrinsic value whatever.

Different kinds of paper money.

There are three kinds of paper money.

1. Such as can be exchanged for coin (gold or silver as the case of the standard currency of the country may be) at pleasure; and is, therefore, made a legal tender; *i.e.* payment thereby is legally regarded as equivalent to payment in coin.

2. Such as can *not* be exchanged for coin at pleasure, and is, therefore, not made a legal tender.

3. Such as cannot be exchanged for coin at pleasure; and which, nevertheless, for public ends, is made a legal tender

Nature of convertible paper money.

The first is the case of the present notes of the Bank of England. They are of a different character from the notes of other banks, because, practically,[1] for every note

[1] The law allows the Bank of England to issue notes to the extent of 15,000,000*l.* on other security than the deposit of gold. But as, practically, the demand for gold in exchange for notes can never reduce the notes in circulation below that quantity, the statement in the text is correct for the immediate explanatory purpose.

issued, the corresponding quantity of gold is locked up in the Bank of England; and, consequently, the Bank is always able to give gold for any quantity of notes which may be offered; so that the notes do not afford an increased quantity of money, except to the extent indicated in the foot-note. They are merely a convenience in carrying about bits of paper instead of gold which is safely locked up and ready to be given in exchange for the notes whenever needed.

Nature of paper money which is not a legal tender.

Paper money which cannot with absolute certainty be exchanged for coin at pleasure, is a different thing. We will first consider such as is not a legal tender; *i.e.* such as one is not legally obliged to accept in payment. This class is best exemplified by the notes of the Scotch banks and of those country banks in England which retain the privilege of issuing notes. As no one is compelled to take these in payment; the use of them depends on the confidence placed in those who issue them; a confidence founded on experience that the notes are always, in fact, exchangeable for coin at pleasure. The use of them therefore is not so widely spread as of other paper money which is a legal tender. They are seldom found much beyond the circle of those who have dealings with the banks which issue them. They are a form of credit. They are advantageous to the limited community which uses them; because they release an equal quantity of coined money for use in trading beyond their circle (Chap. XV. Prop. 5). This may be illustrated

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as follows. Suppose a small community which uses one thousand pounds for mere convenience of exchanges of internal trade (mutual supply of each other's needs). If they can so trust each other as to agree to use a thousand paper tokens for the same purpose; the actual thousand pounds might be lent to others outside their circle; and the community as a whole would be richer by the interest of such loan. Or, if any other trade than 'lending' were prosecuted by means of the thousand pounds; the community would be richer by the profits of that trade.

Such paper money is a form of credit.

All such paper money is only a form of credit. The bankers who issue it, virtually say to their customers, 'You do not really need actual coin for your trade with each other. If you will use these notes in exchange with each other, trusting us to have always the means of giving coin for the notes when coin is needed for trade with distant persons; we shall all be gainers.' The check upon over issue of such notes is the constant liability to give coin in exchange on demand with a penalty of bankruptcy in case of failure.

There is such a thing, however, as paper money which cannot be exchanged for coin at pleasure; and which, nevertheless, is a legal tender. This was the case of the Bank of England notes during the war in the early part of this century. It is at present, the case in America, and several European countries. Such paper money is of a very different character from the two kinds

above mentioned. It is an addition to the quantity of money only limited by the discretion of the Government. If it be issued in excess of the quantity which could be issued if it were exchangeable for coin at pleasure, it must fall in value;—in other words, it must raise prices. This may be shown as follows. We will suppose the coined currency to be gold.

Inconvertible paper money if issued in excess of the quantity which could be issued if it were convertible, must raise prices.

Paper money exchangeable for gold at pleasure commonly named 'convertible notes' does not raise prices; because the prices represent the values of all commodities in exchange for gold; and these values cannot be altered by using the exact equivalent of gold coin. The quantity of convertible notes in circulation, can never exceed the needs of internal exchanges; because if issued in excess of those needs, the quantity in excess is immediately returned to the issuers, to be exchanged for gold which would be available for external (foreign) trade. (See also Chap. x. Prop. 4.)

The State might issue inconvertible paper money in such small quantity that it could never exceed the needs of internal exchange; and, in this case, the inconvertible notes would not raise prices because they would not make the quantity of money in circulation, more than it would have been without them. But, on any other supposition, the quantity of such money must increase the quantity in circulation; because the inconvertible notes are of no use for foreign trade or for any other purpose than internal exchange; and if the quantity of money in

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circulation be increased, prices, *cæteris paribus*, must rise (Chap. X. passim).

The actual experience of this result is abundant. Bank of England notes in the early part of this century, French Assignats after the great French Revolution, American, Austrian, and Italian Government notes at present, are all instances of inconvertible paper money, which have caused a rise of prices (so far as prices are measured by the paper money) proved by the notorious fact of a given quantity of gold or silver purchasing more than the paper money of the same nominal value.

The extent of the fall in value of such paper money evidently depends upon the quantity in excess of the needs of internal circulation at the prices which, *cæteris paribus*, would exist if the circulation were coin, or paper convertible into coin at pleasure; because the value of paper money, as of anything else, must fall, as the quantity offered for sale, other circumstances being the same, is increased (Chap. II. Prop. 14).

Character of an issue of inconvertible paper money.

The purpose of the State in issuing such inconvertible notes in excess of the quantity of convertible notes which it could put in circulation, may be regarded in two ways. So far as there is an intention to redeem the notes by payment of their full nominal value at some future time, it is a mode of borrowing by pledging the future produce of the nation. Regarded as a mode of borrowing, it is open to the objection that the distribution of the loan and of the repayment do not correspond. It is

also, in any case, a mode of taxation. The Government instead of levying, by tax, what capital it needs; purchases what it needs by notes of no intrinsic value, to which it gives a value by enforcing their general acceptance by its own subjects as money. The tax levied is the capital or services received in exchange for the notes. The distribution of the tax is effected by the distribution of the liability to accept the notes as money. Regarded as a mode of taxation, it is open to the objection of unequal incidence; especially as it falls most unduly upon all who have fixed incomes, by reason of the diminished value of the standard money.

The whole process incurs the special inconveniences attending alteration and fluctuation of the value of the money of a community, in their effect on prices, wages and production. Prices (including wages which are the price of labour) must rise in proportion to the decreased value of money (Chap. X. passim). The increased quantity is likely (by increased demand for the means of employing it) to give, at first, a stimulus to trade, which, not being based on any really increased means of production (there being no real increase of capital), is eventually mischievous.[1] Subsequently, the uncertainty in the value of the money adds a risk which must be, in its degree, a hindrance to production.

[1] This consequence was experienced, for instance, on the large issue of inconvertible notes by the American Governmen during the war of 1861 to 1865.

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What is a pound?

In England, during what was called 'the suspension of cash payments,' *i.e.* when gold could not be claimed at the Bank of England for the Bank's notes; and when, in consequence, to purchase a pound in gold, it was necessary to pay more than a pound in notes; there was much discussion as to whether the gold had risen in value, or the paper money had fallen in value; a question which also took the form of 'What is a pound?' The answer to this question is that, at present, so long as no one is compelled to receive anything else but gold coin in payment; a pound is 123·274 grains of gold of a certain fineness, with its quality and quantity certified by the Royal Mint; but that, so soon as any inconvertible money is issued as a legal tender, a pound is a mere name for a mere money token, a thing perpetually variable in value, whose purchasing power, depending upon the relative quantities of such notes and of all other things to be exchanged by means of them, varies with the quantity of such tokens issued; and whose value, expressed in the money of the world, is just so much gold or silver as it will purchase in the market.

It is evident that the question whether, in the case of suspension of cash payments, the difference in value of the coined and paper pounds, indicated a rise in the value of gold money or a fall in the value of paper money, is a mere puzzle of words founded on the ambiguous use of the name 'pound' for two different things. There is a gold coin named a 'pound,' and a

paper money token named a 'pound'; but they are of different values. The pound, whatever else it may be, is confessedly the common measure of exchange value; and the two things cannot both be this common measure. The paper pound is the measure of value for the time, because, as everyone will pay in the less costly paper money, all prices are expressed with relation thereto. The purchasing power of such paper money, is continually depreciated, according to the increasing quantity issued; and in that true sense, it is the paper pound which is depreciated. It buys less of everything else. The gold pound, in such case, buys more paper money than before. But the paper money so purchased, buys less of other things; so that the mere fact of gold purchasing more paper money, is no proof of a rise in the general exchange value of gold, which is the only true sense in which it can be said to rise in value. Of course there is a nominal rise, so far as the value of gold is expressed in terms of the common measure, paper pounds, whose value is falling.

Other proposed schemes of paper money.

The foregoing descriptions include only such paper money as actually exists. Some writers advocate different and novel schemes of paper money, founded on other security than the liability to give gold or silver in exchange. To discuss all these particularly, is beyond the present purpose; but in anticipation of the student meeting with them, the following general observations are pertinent.

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Of the three kinds of paper money above described, two leave the common measure of value unchanged. The third kind changes the common measure of value. All the novel schemes adverted to, admit the need of some restriction of quantity; but aim at a less narrow restriction than the necessity to give coin on demand. These schemes are all analogous to the third kind (adopted by State necessity) in so far as, being restricted in quantity by other means than liability to give coin in exchange on demand, they do change the common measure of value, and being all intended to increase the quantity of money, must, if they answer that purpose, depreciate the money and raise prices.[1]

Character of the English silver coinage.

The English silver coinage was noted above as analogous to paper money; because, although it has an intrinsic value, yet it is considerably below its exchange value. The fact is that the English silver coins are mere tokens for convenience of small exchanges. A shilling is not so much silver in the sense in which a sovereign is so much gold. Its exchange value is not altered though it be worn to half its original weight. It is a money token of the twentieth part of a gold sovereign or pound. No one is compelled to accept payment in silver to a larger amount than thirty shillings. Great conveniences attend the making these tokens in silver. Beside durability

[1] The inconveniences as well as the injustice of such a change would be very great. But it seems sufficient, for the present purpose, to exhibit the fundamental point in the character of such schemes, from which all the objections to them may be developed.

and handiness, their considerable intrinsic value and the liability to refusal if tendered in large quantities, prevents profitable illegal coinage; whilst the difference between their intrinsic and exchange value, prevents it ever being profitable to melt them or to export them as bullion. Nevertheless, they are as truly mere tokens as if they were made of paper. Similar remarks would apply to the copper coinage.

Summary of propositions.

The principal propositions established by this chapter are.

1. It is necessary that a large part of the money of the world should be something which, irrespectively of coinage, has an exchange value equal to its value as money.
2. Inconvertible paper money which is not a legal tender, is a form of credit.
3. Inconvertible paper money which is a legal tender, is a mode of taxation.
4. Inconvertible paper money which is a legal tender, changes the common measure of value.
5. All schemes of paper money restricted in quantity by other means than the liability to give gold (or silver) in exchange, change the common measure of value.

CHAPTER XVIII.

A DOUBLE MONEY STANDARD.

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IN the previous chapter it was said, in relation to the value of money during the suspension of cash payments, that the gold pound and the paper pound, being of different values, could not both be the common measure or standard. But in some countries, France for instance, there exists what is called a double standard. The meaning of this is that both the gold and silver are coined under like conditions, and both are legal tenders. The sense in which this can be described as a double standard (double measure of value), is that either one or the other, according to fluctuating circumstances, *may* be the standard. But, practically, one only, and that the cheapest, can be the standard at any given time. The sense in which one is cheaper, relates to their exchange value as bullion. If the quantity of gold in a twenty-franc piece, will exchange for more silver than there is in four silver five-franc pieces, the gold is the dearer; and everyone will pay in silver if possible; and silver is, practically, the standard. Similarly if the

silver in the four five-franc pieces, would exchange for more gold than there is in the gold piece, silver is the dearer; and all payments will, so far as practicable, be made in gold. Both these conditions have been experienced in France.

CHAPTER XIX.

NATIONAL DEBT.

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THE explanations given regarding wealth (Chap. VIII.) help to show the real nature of a national debt.

Nature of a national debt.

The wealth of a single person, is the acquired right to so much labour, or produce of the labour of others (Chap. VIII. Prop. 4). A national loan is a process by which the Government of a nation purchases the transfer to itself of that right, by pledging the future labour of the nation to the payment of interest, until the retransfer of the right; *i.e.* until repayment of the loan. The payment of interest is made throughout either a fixed or indefinite term of years; and is a first charge upon the nation's labour, to be levied by annual taxation.

How a nation is poorer by State loan borrowed of its own people.

It requires no proof that, so far as the annual interest on a national debt is paid to foreigners, it is equivalent, so long as the debt endures, to a diminution of the productive power of the nation by that amount. But, commonly, the largest part of a national loan is taken from members of the community which borrows. It seems that, so far as this part of the debt is concerned, the nation borrows of itself and repays to itself: Is it

in that case the poorer, and how? This may be explained as follows: CHAP. XIX.

A man has no use of his wealth unless he do one of two things with it.

1. Spending it until it is consumed.

2. Employing it reproductively, either by direct use of it or by lending it; and living, in either case, upon the produce profits or interest.

The first case may be disregarded; because a wealthy class can only exist on the conditions of the second case.

As regards the second case, it may be observed, that if a man lend his wealth to anyone but the State (or to some subordinate governing body entrusted by the State with powers of taxation), it must be for a purpose reproductive to the borrower. Otherwise there would be no means of paying the interest. It is not so in the case of loans to the State, who can repay by means of taxation. The greater part of State expenditure is unreproductive. It thus appears that the difference, in its effect on the whole community, of the loan of its wealth to the State and of any other use of it reproductive to the lenders, lies in the fact that the State spends it unreproductively.

It is evident that a nation may be the richer for State loans judiciously applied to aid production; as, for instance, in constructing roads, harbours, or anything else which facilitates trade. But State expenditure is

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more commonly unreproductive; and the reply to the question how the nation can be poorer by borrowing of itself, is, that it, ordinarily, borrows capital to spend unreproductively, which would otherwise be spent reproductively; and that the payment of interest to those who lent the capital, enables these to live at the cost of the rest of the community without facilitating reproduction, as, by any other loan or use of their capital, they would do.

Consequently, the annual interest of a loan spent unreproductively, is equivalent, so long as the debt endures, to a diminution of the productive power of the nation by that amount, whether the loan was supplied by its own people or by foreigners.

The possible consequences of national debt.

So long as the productive power of a nation is so great that it can easily bear this annual diminution of its produce, the debt is not felt to be a burden; as may be said to be the case at present in England. Even in that case, it diminishes the power of the nation to meet again such a demand on its resources as caused the existing debt. In the event of the produce of the nation's labour becoming much less valuable than previously; the debt might prove a great obstacle to national production. Moreover, it might, conceivably, so promote emigration, by the motive to labourers to escape from a country where the produce of their labour is subject to such large deductions, that payment of the debt might become impracticable. This is not stated

as implying any opinion of what is likely to happen; but only as illustrating the nature of national debt by showing tendencies under certain conceivable conditions.

Comparison of the effects of national expenses met by loans or taxation respectively.

The practice of a nation borrowing of its own members, suggests another important question touching State loans. We may suppose the question stated as follows. A nation whose ordinary revenue is fifty millions, is engaged in a great war; and, to meet the enormous expenditure of the war, borrows one hundred millions which is all spent in one year. The State borrows this sum on the supposition either that it is impossible to obtain a revenue of one hundred and fifty millions for that year, or that it, in some way, gains by borrowing it instead of levying it by taxation. But one hundred millions worth of capital is actually spent unreproductively. From what stock of capital does it come? What produce is diminished in consequence? What, in short, are the essential facts?

Doubtlessly, in countries having such commercial relations as the countries of Europe at present, the capital would be in part provided by other nations. But, for illustration of tendencies, let us suppose the extreme case of the whole loan being made by members of the borrowing nation. In this case, it is indisputable that the nation pays the whole within the year, as truly as if it had been obtained by taxation instead of by loan. The supply is made from the ordinary capital of the nation; excepting so far as it brings out hoards

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which would otherwise remain hoarded. The nation will have spent one hundred millions unreproductively, which it would otherwise have spent, in great part, reproductively; and the produce of succeeding seasons must be proportionally diminished.

To the question 'What produce will be diminished?' the answer must necessarily be,—whatever can be best spared by the people. It seems to follow that, those who will suffer most by the war contribution, are the producers of the things of general consumption which can be most readily spared; rather than those who produce the most necessary things, viz. food. This conclusion seems to be confirmed by experience. (See the note appended to this chapter.)

Of course, so far as the contribution is met by diminution of wholly unreproductive expenditure, the wealth of the nation and its productive power are not diminished. But the workmen previously employed in producing luxuries, suffer by the failing demand for their special services. The note to this chapter shows the confirmation of this by experience.

Effect of loans in bringing out hoarded money.

Again in some countries national loans may bring out hoards of money which would have otherwise remained hoarded. This was supposed to be the case recently in France. In such a case, if the money which would otherwise be hoarded be exchanged for commodities of other nations; the bringing out such hoards must be

almost entire gain to the borrowing nation (by inference from Chap. XVI. Prop. 12).

The convenience of loans.

The difference in the supposed case, between borrowing from the nation and levying the whole sum by taxation, is in the distribution of the burden. To explain all the inconveniences of imposing such extraordinary taxation, it would be necessary to anticipate the chapter on 'Taxation.' It may be said, anticipatively, that the practical difficulties in distributing it equitably by direct taxation would be enormous; whilst suddenly imposed indirect taxation to such a large amount, would interfere with trade most mischievously, by its effect on demand. The process of borrowing enables capitalists to make the best possible distribution of the diminished quantity for reproductive purposes. The State also, in distributing the burden, has to deal with the comparatively small sum of yearly interest; and can, therefore, distribute it equitably without extraordinary inconvenience of any kind. (For explanation of these remarks see Chap. XXVI. on 'Taxation.')

Convenience of borrowing of foreigners.

So far as the capital may be supplied by foreign countries, the borrowing nation avoids all the cost of the immediate expenditure, *i.e.* all the loss and inconvenience attending the withdrawal of capital from the existing trades; and it only incurs the constant future cost of interest.

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NOTE.

Tooke in his 'History of Prices,' arguing against the supposition that war necessarily raises prices, shows that the high prices of food which so prevailed in England during the great war at the beginning of this century, were due principally to the scarcity of bad harvests; and partly due to the hindrance to importation caused by the war. (Vol. I. Part II. Chap. IV. and Part IV. Chap. V. Sec. 11, 'History of Prices.') He shows that times of war have, on the whole, been characterised rather by low prices of agricultural labour and produce. (Vol. I. Part II. Chap. III. Sec. 1.) This is what may be inferred from the abstraction of capital from reproductive purposes, which he admits (Vol. I. Part II. Chap. IV.) to be the first consequence of great war expenditure. For, besides the diminution of money in circulation or of equivalent credit, which must attend diminution of capital (Chap. XVI. Prop. 9 of this treatise) excepting so far as the circulation may be kept up by the issue of inconvertible paper money; the deficiency of capital must tend to lower wages generally (by inference from Chap. XII. Prop. 4). Moreover, the destruction of international credit caused by war, notoriously causes an extraordinary demand for the use of gold and silver; and this being equivalent to a scarcity of the metals, must tend to lower prices generally.

Of course, on the other hand, so far as war may make any particular thing scarce, it may raise the price of that thing. If war prevent an usual import of food; it will raise the price of food and, in some degree, the food producers' wages. But the foregoing remarks show how deductive reasoning from the propositions previously established in this treatise, is concurrent with the results of Tooke's laborious inductive review of the historical facts.

In further support of the inference in this chapter, that the burden of war expenditure falls most heavily on the producers of the commodities which can be most readily dispensed with; the following considerations are pertinent.

War cannot much increase the demand for food; and we may assume that food is the last thing of which the demand will be readily diminished. So that there seems no reason to expect war to change the price of food excepting by two means—viz. firstly, a diminution of supply, as may happen by ravage in a country which is the theatre of war or by prevention of import; secondly, a share in the general diminution of prices to be expected as shown above.

If the supply of food be not diminished; other produce *must* be diminished because of the diminution of capital. Tooke, speaking of the years 1810–11, says: 'Whilst the wages of agricultural labourers and artisans had been raised in a considerable, though still inadequate

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proportion to the increased price of necessaries; this was not the case, or only partially so, as regarded the wages of working people in manufactories. Considerable numbers of these had no advance of wages; or, if they had, the advantage was more than compensated by reduced hours of work.' (Vol. I. Part IV. Chap. V. Sec. 5.) This concurs with the conclusion in the text.

CHAPTER XX.

THE PUBLIC STOCKS.

THE rise and fall of the price of stocks is a constant phenomenon of much significance.

What the public stocks comprise.

'The Public Stocks' mean all the State debts and the property in the various undertakings, such as banks, railway companies, mining companies, &c., the shares of which are sold publicly.

The State debts are the interest on loans borrowed by the State. There are several ways in which States negotiate loans; but it is unnecessary to describe them. In whatever way obtained, a State loan is, in effect, contributed by many persons in various shares; and each creditor is entitled to a fixed rate of interest on his share. The subject of sale in the stock market, is each several creditor's claim against the State (for interest or for repayment).

Nature of sales of State debts.

A having lent to the State, say, 1,000*l*, at 3 per cent. interest, has a perpetual claim against the State for 30*l*. a year until repayment of the principal sum. This claim he may sell to B; who may sell it to C; and, so on, indefinitely; but the thing sold, be the transaction re-

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peated ever so often, is A's original claim against the State.

Why the price of State debts constantly fluctuates.

It will be easily seen why the prices of such stocks continually rise and fall, and why public events affect their prices. The fluctuation depends upon the current interest of money. Considering the supposed instance of A's loan of 1,000*l.* to the State; it is evident that, if a man, by any other use of 1,000*l.*, can, with equal security and convenience, obtain, say, 5 per cent., *i.e.* 50*l.* a year for it; he will not give 1000*l.* to obtain A's claim to 30*l.* a year. The 3 per cent. stock to which A's claim belongs, is, in that case, said to be 'below par.' Similarly if we suppose the loan to have been made when the State's need and the scarcity of money was such that the State had to pay 5 per cent., A's claim would be 50*l.* a year. And if, subsequently, capital should become more plentiful so that a man could not obtain more than 4 per cent. for his money, with equal security and convenience; he would give more than 1,000*l.* for A's claim of 50*l.*; and the 5 per cent. stock would be 'above par.'

How public events affect the price of stocks.

Public events affect the price of these stocks, because they affect the demand for money; and so affect the rate of interest; and so, necessarily, affect the value of all employment of money, on which the rate of interest is fixed. A demand for money, is a demand for the use of capital. War, for instance, causes a great unreproductive expenditure of capital, and, therefore, makes it scarce; and, therefore, raises interest, the price of the

loan of the use of it. Anything which threatens war, raises the rate of interest by anticipation of the consequences of war.

Similarly, anything whatever which causes, or is very likely to cause, an increased demand for capital, raises the rate of interest; and, consequently, affects the prices of these stocks.

Cotemporary differences in the prices of various State stocks.

The cotemporary differences in the price of various State stocks, depend upon several circumstances. Of course those which pay higher interest, must, *cæteris paribus*, bear a higher price. Again some States are supposed to afford imperfect security for the constant payment of the interest; and all such risk must of course tend to raise the price which the State must pay; which is equivalent to a lower price to purchasers of the stock. But the State loans of the great Powers, vary in price quite independently of any question of solvency. Thus, the French 5 per cent. Rentes, sell, at present, at about 95 per cent.; that is to say, 95*l.* will purchase the right to 5*l.* interest per annum, until the debt be discharged by payment of 100*l.*; whilst the English 3 per cent. stock sells at about 93, that is to say, 93*l.* is required to purchase the right to 3*l.* interest per annum. The principal cause of such differences, must be the difference of the general rate of interest in the two countries. For, it is notorious that the French people showed, by their universal eagerness to contribute to the 5 per cent. loan, that they do not doubt the solvency of their State; and as the

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greater part of this loan was taken by the French people; the price paid in the first instance, must have been principally determined by the rate of interest on good security in France. *À fortiori*, the present price, though low as compared with the English funds, being positively higher than the original price, cannot now be due to any notion of comparative solvency; but must be mainly due to the difference of general rate of interest in the two countries. Other circumstances contribute to the difference of price. The legal obligation to invest many trust funds in the English stocks, causes a very large demand which must tend to raise their value. The mere prejudice in favour of the stocks of one's own country, or what is nearly equivalent to such prejudice, the uncertainty attending ignorance about foreign means of investment, restricts the demand for foreign investments; and, so, tends to keep down their price.

Again, a State debt bearing a high rate of interest, is more likely to be paid off than another debt, by the same State, at a lower rate; and this circumstance tends to lower its relative price by restricting the duration of the advantages it offers. For instance, the French 3 per cent. Rentes are quoted at present at 59, whilst the 5 per cent. Rentes are at 94⅛, prices which give interest, on the purchase money, at 5·08 and 5·29 per cent. respectively. If capital should become more abundant in France, causing a diminution of the rate of interest (Chap. XI. Prop. 6); that diminution would tend to raise the value of

both the 3 per cent. and 5 per cent. Rentes, because those rates of interest are fixed. But, on the other hand, it might lead to the State paying off the 5 per cent. loan; whilst there is no probability of such a consequence as respects the 3 per cent. This consideration of greater permanence and of consequent probability of greater gain to holders of 3 per cent. Rentes by any general increase of capital, may be reasonably assumed to be the reasons of the difference of price of the 3 per cent. and 5 per cent. French Rentes.

Nature of sales of other than State stocks.

As respects the other kinds of public stocks, such as shares in banks, railway companies, &c.; the subject of sale, is a certain share of the subscribed capital of the business and of the property into which that capital may have been converted and of the profits of the use of that capital and property. A having contributed 500*l.* to start a bank, to make a railway, or for any other analogous purpose, and the total sum subscribed for that purpose being, say, 500,000*l.*, reckoned, say, as 5,000 shares of 100*l.* each; A is the owner of one thousandth part of the whole business its property and profits, expressed as the possession of five shares of the capital stock; and these shares he can sell to anyone else.

The prices of these kinds of stocks are not only subject to the same causes of fluctuation as the State debts, but to the uncertainty and fluctuation of the return of profit or interest, and all the conditions of ability, prudence, and trustworthiness of managers and

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other circumstances of each business which affect the return of profit or interest.

Fluctuations of price of *State* stocks have more general significance.

Hence, the fluctuation of the price of State stocks, the interest of which is fixed, has much more general significance than the fluctuation of prices of other stocks; because the first is more exclusively determined by the general abundance or deficiency of capital.

CHAPTER XXI.

FOREIGN EXCHANGES.

The nature and occasions of foreign exchanges.

THE foreign exchanges mean international payments of money; payments made by persons living in one country to persons living in another country. The causes of these payments are various. The following may be regarded as the principal. Export and import trade; sea carrying trade; remittances to persons who have property in one country travelling or living in another; purchases of foreign stocks and other foreign investments; payments of dividends on foreign investments.

The trouble and cost of actually sending money to a foreign country, induce the substitution of credit so far as possible.

We will, in the first instance, consider the matter irrespectively of differences of kinds of money; and will speak as if all international debts were calculated in English gold money.

The mode in which exchanges are effected.

The means by which credit effects the payments without actual transfer of money, is by transfer of debts. If A in France owes 1,000*l.* to B in England and B in England owes 1,000*l.* to C in France; the two debts

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could be settled by B directing A in France to pay his neighbour C 1,000*l.*, *i.e.* by B transferring to C A's debt to himself (B). And if B does not owe anything to anyone in France; yet if some one else, say D, owed 1,000*l.* to some one in France, the debts would be settled by D purchasing from B A's debt to him and then transferring it to his own creditor in France.

But the conveniences of trade do not leave each one who has a debt to pay in a foreign country to find out some one who has a corresponding debt to receive from that country. Certain persons make it their business to buy these debts and to sell them again in the quantities which each may need. Each creditor of a person in a foreign country can thus sell his claim for money paid in his own country; and each debtor to a person in a foreign country can buy the means of paying his debt by money paid in his own country.

This, elementarily, is the mode in which we see that payments are made from persons in one country to persons in another country.

It is obvious that, in the above-stated manner, payments can be effected between two countries without actual transfer of money, so far as the mutual debts of the persons in the two countries, balance each other. But this is not the limit of the substitution of transfer of debts as a mode of payment. If the debts from persons in England to persons in France payable at a given time exceed those due, at the same time, from persons

in France to persons in England, the difference is not necessarily paid in money. If, at the same time, the debts due from Russia to persons in England were in excess of the debts due from England to Russia, the payment of the balance due to France might be paid, in whole or in part, by transfer to persons in France of the Russian debts. Experience shows that this complicated transfer of debts between all intertrading countries, is carried to the utmost convenient extent, so as to reduce the actual transfer of money to a minimum. The means by which these transfers of debts are made, are bills of exchange.

Bills of exchange.

A bill of exchange is simply a written demand by one person (presumably a creditor) to another (presumably his debtor) to pay a stated amount to a stated person. The sale and purchase of debts noted above, is effected by means of sale and purchase of bills of exchange. The price is determined by laws analogous to those which determine other prices. These prices vary according to several circumstances. In the first place, some bills are intrinsically more valuable than others for the same amount. Bills drawn by a well-known bank or firm upon an equally well-known foreign bank or firm will be more generally accepted than bills representing debts between obscure persons. The former are more valuable, both because of the greater certainty of their being paid and by the convenience attending their more general acceptability. But this is only

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the difference between an inferior and superior article of the same kind. Again, bills are drawn payable at sight or at ten days' sight or thirty or sixty days' or ninety days' sight or other periods. These specified dates mean, respectively, that the debtor is bound to pay immediately the bill is presented, or ten days after or thirty days after or sixty days after, &c. It is evident that a bill payable after six months, is less valuable than one payable at sight, by the interest of the money for six months. Moreover, in some cases, the liability to some difficulty in procuring payment, which may occur in the interval between presentation and due date of payment, by insolvency, death or other such cause, diminishes the value of a bill drawn at long date.

Causes and limits of the fluctuation of price of bills of exchange.

The foregoing differences are differences of value inherent in the nature of the bills. But bills of equal value in the foregoing respects, differ in value at different times from other causes. The principal cause is the difference between the sums mutually due at a given time between two countries. The supply of debts by means of which the payments can be effected by mere transfer is limited; and, consequently, when the demand for them at a given price exceeds the supply, the price rises by the ordinary law of equation of supply and demand. But as, ordinarily, the purpose of a bill of exchange is to save the cost of transmitting money, the rise of price of a bill is ordinarily limited by the cost of transmitting money instead. Similarly, when the supply

at a given price exceeds the demand, the price falls, the fall being similarly limited by the cost of transmitting money. Thus if persons in England owe more to those in France than the latter owe to the former, there will be a greater supply in France of bills on England than in England of bills on France. The bills on England fall in price and the bills on France rise.[1] The fall is limited by the cost of transmitting money.

The operation of the cost of transmission of bullion as a limit to the rise or fall of the price of bills of exchange, is not absolute. It is like the limit of rise or fall of price of goods, imposed by cost of production. Temporary exigencies may cause prices to fall or rise indefinitely beyond the limits so imposed. It is the same with bills of exchange. The sale of a bill of exchange, being, in effect, the exchange of a sum of money to be paid in another country at a future date for a sum of ready money; it will be evident that, in case of a general pressing need for ready money, the price of it would not be limited by the mere cost of transmission.[2]

Another cause of fluctuation of price of bills of exchange, is the differences of kinds of money, a con-

[1] This simple case is in fact complicated in such ways as indicated by the previous supposition that although the English bills on France were insufficient, there might be English bills on Russia which it might be convenient to France to accept in payment. But the simple case stated shows how the price of bills is determined.

[2] It may of course be said that the cost of transmission includes interest, and that the low price of the bill represents the high interest of money; and that cost of transmission is proportionally increased by the high interest.

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sideration hitherto excluded. The relative values of gold and silver vary; and their values relatively to an inconvertible paper currency, vary still more. Consequently a debt in gold exchanged for a debt in silver, or in paper money, is not always exchanged, *cæteris paribus*, at the same rate. But the principal cause of variety of price of a given class of bills, is the equation of supply and demand, as above explained.

We have spoken of all bills of exchange as a means of transferring debts, and, therefore, as representing debts. Elementarily they do represent debts; and in form they always do so. But in fact many bills do not really represent debts. A very large number represent anticipated debts; as when a merchant in one country draws bills on a correspondent abroad, because he has sent certain merchandise to him to be sold in his behalf, the proceeds of which sale he anticipates. He anticipates the debt which will become due to him by the sale of the goods on his behalf. Moreover many bills do not represent even anticipated debts; but are a means of borrowing. A merchant or banker in one country borrows from another abroad by drawing bills on him. But even in this case, a previous engagement to pay such bills must exist; and a promise to pay money on demand, though it be in fact a loan, is in respect of the obligation imposed by the promise, a debt in one sense. So that these practices do not interfere with the elementary

conception of all the transactions effected by bills of exchange, as transfers of debt.

Summary of principal propositions.

The principal propositions in this chapter are

1. Foreign exchanges are the payments of money between persons living in different countries; and these payments are effected, so far as possible, by exchange of mutual debts.
2. Export and import trade, sea carrying trade, remittances to persons who have property in one country whilst residing or travelling in another, purchases of foreign stocks or other foreign investments of capital, payments of dividends on foreign stocks or investments, may be regarded as the principal causes of these mutual debts.
3. The exchange and transfer of debts is effected by documents named 'bills of exchange' which are sold by those who have to receive money from foreign countries, to those who have to pay money in foreign countries.
4. The differences between the total sums due to and from a given country at a given time which cannot be adjusted by transfer of debts, is paid by actual transmission of money.
5. The prices of bills of exchange proportionate to the sums named in the bills, in other words, the *rates* of exchange, vary according to the credit of those who draw them and of those on whom they are

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drawn, and according to the time which will elapse before payment, and according to the relative values of the different currencies, and, principally, according to the intensity of demand which varies according to the difference between the sums due, at the time of sale, to and from the country in which they are sold.

CHAPTER XXII.

TRADE.

By trade we mean all processes of exchange of labour and of produce.

Definition of trade.

There can be no advantage in exchange of produce, if each party to the exchange could, with no more expenditure of his own labour, supply himself equally well. There must be advantage (as respects increase of production and wealth) in exchange, if, by it, less labour is required to meet the needs of the exchangers.

Nature of the benefit of trade.

Consequently, the general benefit of trade consists in the division of employments, by which each person (or community) produces what each is most fitted, by circumstances, to produce; and, so, production is increased on the whole; and each person (or community) meeting his own needs partly by exchange instead of attempting to meet them wholly by his own labour; all, by exchange, share in the general increase.

Nature of profit of trade.

Profit of trade, as distinguished from common benefit, evidently consists in procuring produce of greater value to the receivers than the labour and capital expended on the things given in exchange.

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In trade, beside the producers who are the first sellers, and the consumers who are the last buyers, there are intermediate buyers and sellers who perform certain functions. These functions comprise the work of the merchant, including, in the name, retail as well as wholesale dealers; although, in common parlance, only wholesale dealers are named merchants, and retail dealers are named tradesmen.

Nature of wholesale trade.

Wholesale trade, by common use, signifies trade in which sales are not made according to individual needs, but according to the general need of a certain country, province, district or community.

Nature of retail trade.

Retail trade means the supply of individual needs.

The work of a wholesale dealer consists, principally, in effecting the necessary transfers of produce from one place to another.

The work of a retail dealer consists in distributing the produce, within a certain narrow circle, according to individual needs.

The function of the merchant.

Nevertheless, the work of the wholesale and retail dealer is one, in nature, as being the means of communication and settlement of exchanges between distant producers and consumers.

The agency of the merchant is an employment of capital and of merchant's labour; and the cost of these is equivalent to an additional cost in production; because it is an actual addition to the cost of producing the things for sale to the consumers. Consequently any

avoidable mercantile agency is wasteful, unless, by division of employments, it saves more than it costs.

The remuneration of the merchant may be regarded as comprising profit on the capital he employs, and wages for his own labour. Both are paid by means of an enhanced price to the consumer.

The remuneration of the merchant.

It is obvious how the work of the wholesale trader is aided by all facilities of transport and communication, such as roads and telegraphs. Facilities of transport not only lessen the direct cost of conveyance; but, by saving time, save interest on the capital employed; and this is equivalent to a saving in cost of production (Chap. XI. Prop. 4). Facilities of communication, by obtaining early and accurate information regarding distant markets, diminish the merchant's risk.

How facilities of transport and communication aid wholesale trade.

Thus, it appears that the elements of most effective trade are, a minimum of cost in production, of time between production and consumption, of cost of transport, and of cost of merchant's agency in transport and distribution. Any departure from these conditions must lessen the general wealth of the community.

The elements of most effective trade.

In proceeding to indicate the limits of trade, it is useful to point their significance by notice of the frequent phenomenon of a general difficulty throughout the mercantile community, to meet their several engagements. An individual bankruptcy depends upon individual errors; but what are the causes which induce an approximately general bankruptcy?

The limits of trade.

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Surplus produce the whole means of a nation's trade.

The produce of a nation's labour is the whole means of a nation's expenditure; and the surplus beyond that which is consumed without return, is the whole means of a nation's trade.

Pledging future produce a principal cause of general difficulty to meet engagements.

But although a nation, as represented by its mercantile community, has not any means of trade beyond the above-mentioned surplus produce; yet it can, and an active mercantile community always does, more or less, pledge its future produce or its future returns of capital; and there are the strongest inferential reasons for regarding this habitual anticipation of future incomings, as a principal cause of the general difficulty in meeting engagements, in which the whole mercantile community is sometimes involved. The mode in which such anticipation of incomings might operate ruinously, was illustrated in Chapter XIII. on 'Credit.' It may be further explained as follows.

If a man possess certain property and have expectation of more; he may lose the one and be disappointed of the other; and yet, though thrown into poverty, may never be unable to pay his debts. But if he had borrowed money on the security both of his possessions and expectations; he would be hopelessly bankrupt, unless he had used the borrowed money in successful trade. The mercantile community habitually borrows on both its possessions and expectations; and when, as sometimes happens, the employment of the borrowed means is subject to the same influences as have greatly di-

minished the previously supposed value of its expectations, or perhaps even of its possessions also; it is evident that failure to meet engagements is inevitable.

The principal causes of unfounded general expectations of trade profits.

We will consider some of the principal causes of a greatly diminished value of the expectations of the mercantile community; or, what is equivalent, the causes of unfounded expectations.

The available produce for each year's expenditure being a limited quantity, so much as is spent for one purpose, diminishes the supply for other purposes; and, if an unusual quantity be taken for one purpose, there will be an unusual deficiency for another.

The produce which is surplus after sustaining the community, may be regarded as all spent in

1. Unreproductive measures of public policy, such as the maintenance of the army, the navy, and the whole State machinery.

2. Luxuries (using this term, in a wide sense, to denote all unreproductive expenditure beyond the public administrative needs and the standard of needful personal comfort).

3. Conversion into fixed capital, such as the construction of roads, canals, factories, machinery and necessary dwellings.

4. Means immediately reproductive of capital, such as agriculture, manufactures of necessaries of life or comfort, or of whatever is needed in foreign markets.

An unusually large expenditure of the first kind, if

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Effect of unusually large State expenditure.

not provided for by a State loan, must be provided for by additional taxation. In this case, the withdrawal of capital for the purpose is directly felt and measured by means of the taxation; and, therefore, is not likely to cause misapprehension of the means available for other purposes.

Effect of unusually large conversions to fixed capital.

Unusually large expenditure of the third kind often leads to serious misapprehension. The great expenditure in constructing railways in the years 1843 to 1845 was a good illustrative instance. The abstraction of capital, in such a case, is most evident on reflection; because, the expenditure, not being immediately reproductive of capital to the nation, but only likely to aid production of capital in future years, it is certain that the immediate cost can only be met by the sacrifice of other purposes. Nevertheless, this obvious consequence is often ignored by the trading community. Because each several undertaking is supposed likely to be profitable to the undertakers; each one thinks that, by means of credit, he may reasonably apply nearly as much capital to other purposes, as before; and each, severally, acts on this conclusion; notwithstanding the certainty that the collective means for other purposes, is greatly diminished.

Such excessive appropriation of capital for conversion into fixed capital, is generally caused by speculative excitement; which is often both the consequence and the cause of unreasonable expectation of profit; so that the

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temper of the community at such a time, is not favourable to such just observation of inevitable tendencies as would check the excessive appropriation of capital in one direction.

Effects of speculative excitement.

Speculative excitement also leads to excessive expenditure on luxuries; because each one of the multitude who, in such times, take a part in the favourite schemes, believes that their rising value (often due only to the desire to share in them) is a proof of incoming profit; and that, consequently, he is richer than before. Thus, each increases his personal expenditure at the time when there is really, on the whole, less capital available for the purpose.

Effect of unusually large appropriation of capital to reproductive expenditure.

It is evident that, similarly, any general expectation of unusual profit by manufactures or by foreign trade, would cause a diminution of means for other purposes; whilst the same expectation might induce each severally to believe his means, credit included, to be rather increased than diminished; and the whole community would act accordingly.

Unusually large expenditure of capital attended by want of money.

If, in any of these ways, a community, by means of unfounded credit, trades beyond its real resources of capital, *i.e.*, in essential fact, makes purchases without real means of paying the price when due; the result must be felt as a want of money. When the pledges of future capital implied in all credit operations, have to be redeemed; there is insufficient capital for the purpose; and the unredeemed debt is a debt of money. If im-

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ports have been temporarily purchased in excess of the value of exports; the difference must be paid in money. If goods have been exported in excess of the demand for them; the excess is, temporarily, equivalent to the expenditure of so much capital without return. If manufactures have been extended beyond the demand for them; the inability to sell, makes such excess the same thing, temporarily, as an equal expenditure of capital without return; and the obligations incurred in expectation of the sale of the goods, are felt as a want of money.

As money proper is not actually consumed like the capital it represents; we have to consider what is the process by which money actually becomes scarce or is felt to be scarce.

In the first place, when capital is scarce, a great quantity of that which, in its immediate operation, is equivalent to money, viz. credit, is really destroyed.

2. Credit being diminished, each banker and trader requires more money in reserve (the reason will be explained in a future chapter; but it is a matter of common experience).

3. Money may leave the country because it is actually owing to foreigners in payment for large importations for which there are no immediately equivalent exports.

4. Money may leave the country because it can be

more profitably employed elsewhere, where capital is plentiful, than in the country where capital is scarce.

In any or all of the foregoing ways the general scarcity of money amongst the trading class, commonly spoken of as 'a commercial crisis,' may happen.

A general want of money caused simply by spending capital faster than it is produced.

It is needful to apprehend this clearly, that a want of money means a want of capital, caused simply by capital having been expended faster than it is produced. A want of money by the mercantile community, is exactly analogous to the want of it experienced by any private person who has spent his means too fast. The want can only be met immediately, by borrowing on the security of future means. Further important considerations connected with these remarks, will be shown in the chapter on 'Currency.'

Summary of principal propositions.

The principal propositions in this chapter, are

1. The general benefit of trade consists in the division of employments, by which, each producing what he is most fitted, by circumstances, to produce, production is increased on the whole; and all, by exchange, share in the general increase.
2. Profit of trade consists in procuring produce of greater value to the receivers than the capital or labour expended on the things given in exchange.
3. The remuneration of the merchant, may be regarded as comprising profit on the capital he employs and wages for his own labour.

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4. Facilities of transport are equivalent to less cost in production, both by saving direct cost of transport and by saving interest by saving time.
5. Facilities of communication are equivalent to less cost in production both by saving time and by diminishing risk.
6. The elements of most effective trade are
   a minimum of cost of production,
   „ of time between production and consumption,
   „ of cost of transport,
   „ of merchants' agency in transport and distribution.
7. The surplus produce of a nation's labour, beyond what is consumed without return, is the whole means of a nation's trade.
8. The means of a nation's trade at any given time, is the existing surplus produce at that time added to the credit which can be established on expected produce.
9. Trading on expectations is a common cause of mercantile bankruptcy.
10. A temporary general want of money amongst the trading class, means a want of capital caused by spending it faster than it is produced.

CHAPTER XXIII.

FOREIGN TRADE.

FOREIGN trade has the peculiarity that the buyers and sellers live in different countries, and belong to different nations; and this gives rise to special considerations requiring separate notice.

Nature of foreign trade.

Foreign trade is, in its nature, exactly similar to internal trade. It is the exchange of the produce of the labour of one man for that of another. Its use is to procure, from abroad, such things as either cannot be made at home, or cannot be made so well or so cheaply at home.

From this perfect analogy, some simple but important conclusions follow.

Character of exports and imports.

Exports are sales; and the imports are the great part of the value received. Making no distinction between bullion and other commodities, the true measure of the value of the exports is the quantity of the imports.

Tendency of exports and imports to equal value.

There are certain cases of international payments made without any direct material return. For instance, remittances to persons who have property in one country whilst living in another (and this case would include the

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remittance of dividends on the stocks of one country to shareholders in another country); claims against the State of one country, payable in another, such as the large sums paid as salaries and pensions by the Government of India to persons in England. There are also payments without immediate *equivalent* return, such as capital remitted for employment in foreign countries. There are, of course, corresponding cases of international *receipts* without material return. These cases excepted, the exports and imports of a country are only mutual payments for value received; and must be of equal value; because, the value of a thing being what it will obtain by exchange; the sum of all things given by a country in exchange, must be of the same value as the sum of all things received in exchange.

Ambiguity of values of exports and imports.

The comparison of values of exports and imports, is, however, subject to special ambiguity, which it is desirable to obviate by careful explanation.

If an Englishman produce 1,000 bales of cloth and he exchange them with a Frenchman for 1,000 casks of wine, the total value of the cloth equals the total value of the wine by virtue of the fact that the owners mutually agree to the exchange. This equality of value is not affected by any difference in the cost of producing the cloth and wine respectively.

The intervention of money can make no difference. If the one sold his cloth bale by bale, and bought the wine cask by cask, at such prices that the result was

exactly to exchange the 1,000 bales for the 1,000 casks; the payment of money would not alter the fact that the stated quantities were of equal value.

Further, if the result of the sale of the cloth and the purchase of the wine, was, that the Englishman had finally given all the cloth and 1,000*l.* besides for the wine; it is indisputable that the 1,000 bales plus 1,000*l.*, equal in value the 1,000 casks of wine. This remains the same whatever was the cost of production of each.

If instead of one man exchanging with another, we substitute one nation exchanging with another nation, it remains equally true that the sum of the things sold or exported, bullion and money included, must equal in value the sum of the things imported in exchange.

Let us now introduce the element of cost of production.

Suppose that each bale of cloth cost labour and capital valued in England at 9*l.*; and that each cask of wine cost labour and capital valued in France at 10*l.*; and suppose also as before that a bale of cloth exchanges equally with a cask of wine. It is evident that there is a profit to England in the sense of obtaining the produce of labour and capital of greater value than was expended on the things given in exchange. This profit to one is not loss to the other. France has obtained the cloth either better or cheaper, or, in some way, more conveniently than she could otherwise have ob-

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tained it. But we see that this kind of profit does not affect the relative values of the things exchanged.

If now, in addition to the two nations as mutual producers and consumers, we introduce a merchant of each nation; we have value in another relation.

Suppose that each bale of cloth costs the English merchant 9*l.* at the port of import, and each cask of wine costs the French merchant 10*l.* Suppose also the price of each at the port of import to be 11*l.* The merchant's profit, quite distinct from the national profit above mentioned, depends upon the difference between what the wine costs him and what he sells it for. The English merchant might sell the wine at the same price which he paid the Frenchman for it (11*l.*) and yet having sold cloth for 11*l.* which cost him 9*l.*, he would make 22 per cent. profit on the whole transaction of exchange of cloth for wine. Similarly, he might sell it at less than he paid for it, say, 10*l.*, and yet make 11 per cent. profit on the whole transaction.[1] The French merchant

[1] It may be thought that a merchant would not do this; but would make the 22 per cent. by sale of the cloth and devote the money received for the cloth, to some other purpose than buying wine at 11*l.* to sell it at 10*l.* He would, of course, endeavour to do so; but it must be remembered that the bales of cloth and casks of wine, in the argument in the text, represent the entire export and import trade of one country with all foreign nations collectively; and, certain conditions excepted, which will be explained in a later part of this chapter, payment for exports must be taken, on the whole, in goods not in money, and in such things as the foreign nations have to give and the importing nation needs. In this view, there is practically no choice as to buying the wine. It is the only condition on which the cloth can be sold.

similarly makes a profit if he sell his cloth for more than 10*l.* Say, he sells at 10*l.* 10*s.*

From the foregoing, we have, now, the following various and differing statements of value; which are all severally true in certain relations.

1. A bale of cloth and cask of wine are equal in value and are interchanged at a price of 11*l.* each.

2. The English merchant representing the value of his exports and imports, respectively, by the money he received for them, would show the value of each bale of cloth as 11*l.*; and of each cask of wine as 10*l.*

3. The French merchant would similarly show the value of each bale of cloth as 10*l.* 10*s.*, and of each cask of wine as 11*l.*

4. The English merchant comparing what he received for the cloth with what he received for the wine, might make it appear that he had exchanged cloth of the value of 11,000*l.* for wine of the value of 10,000*l.*, whereas he had really made a profit of 11 per cent. (The fallacy of the comparison consists in comparing what he finally received for the wine with the price he received for the cloth, instead of with what the cloth cost him.)

5. A trade return might be made from the merchant's statements, which would show England's exports valued at 11,000*l.*, and her imports at 10,000*l.*; whilst, in fact she had obtained, in exchange, the produce of labour and capital of greater value than was expended on the cloth.

The application of these illustrations would not be

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essentially altered, by substituting for one nation trading with one other for one commodity from each, the complication of the actual trade with many nations in many things.

Distinction of international values and home values.

These illustrations will show the ambiguities to which the interpretation of trade returns is subject, and the need to distinguish between what may be called international values and home values respectively. For instance, in the above-stated cases, the international values of a bale of cloth and cask of wine were equal and each was expressed by 11*l.*; whilst the home values were, in England, cloth 9*l.* and wine 10*l.*; and, in France, cloth 10*l.* 10*s.* and wine 10*l.*

The example given above of how the merchant might possibly seem to buy and sell the wine at a loss, whilst it really brought him some profit, is significant, as affording a likely explanation of some not infrequent cases of trading at a seeming loss. The present writer is assured that cotton is frequently bought in India for shipment to England at prices exceeding what it will obtain in Liverpool; and, similarly, that piece goods are sometimes sold in India for less than they cost in Manchester.

Thus far, no distinction has been made of bullion and other commodities. Bullion being used as international money, it is needful to consider some circumstances of the export and import of it, exclusively of other commodities.

It is evident that the receipts and payments of

Tendency to equality of exports and imports of bullion.

bullion, by any one country, must, in the long run, balance each other, unless there be a predominant outflow or inflow of bullion.

Restrictions of constant outflown inflow of bullion.

It is further evident, the case of a bullion-producing country excepted, that a constant outflow cannot endure indefinitely; because a constant outflow would so raise its value in the given country, by scarcity, that it would inevitably come back from abroad to so good a market (Chap. II. Prop. 14). Moreover, a constant inflow can only endure in so far as the convenience of trade needs more bullion for use as money; or the needs of society require more for other purposes than money. These needs include the small constant inflow which may be due to the constant increase of the quantity of available gold in the world. A constant inflow of bullion beyond these needs, must so lower its value in the given country, as to ensure its export to countries where it would be of more value; so counteracting the inflow.

Consequently, with the large exceptions above stated, the imports and exports of bullion used as international money, to and from any country, tend, effectively, to equal each other in value, in the long run.

It must be remembered, however, that, in some cases, the stated exceptions to the foregoing tendency seem to endure indefinitely. For instance, the needs of Asia, both for more money and for other purposes than money, induce a constant large import of silver to India which seems likely to endure for an indefinite time.

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The following principal propositions have been established in the course of the foregoing remarks.

1. The exports of a given country must equal the imports in value (bullion included in both cases) plus or minus the difference of the payments made or received by that country without immediate material return (such as remittances to persons who have property in one country whilst living in another, or remittances of dividends on the stocks of one country to shareholders in another; or remittances of capital for employment in foreign countries; or claims against the State of one country payable in another).
2. The imports and exports of bullion to and from a non-bullion-producing country tend effectively to equal each other with certain large stated exceptions.
3. It follows as a consequence of the foregoing propositions; that, *when other circumstances are unchanged*, any alteration in the *quantity* of goods exported, must be attended by such alteration of the *value* thereof, or of the quantity or rate of value of imports, as will maintain the previous relative value of the total exports and total imports. Similarly any alteration in the *value* of goods exported, must be attended by an equivalent alteration of the *quantity* of exports or of quantity or rate of value of imports.

The practical application of these conclusions will appear in the course of the following observations.

Practical application of preceding propositions.

In illustration of the bearing of the first of the foregoing propositions, we may notice the fact that large sums are annually paid in England on behalf of the Government of India on such accounts as salaries and pensions for which there is no material return. Consequently the exports from India (bullion included) must proportionally exceed the imports in value. The trade returns correspond.[1]

The case of Indian trade.

[1] The following is taken from a return made to Parliament:—

Total value of merchandise and treasure respectively imported into and exported from India by sea, from and to foreign countries, in each of the under-mentioned years.

Years	Imports			Exports		
	Merchandise	Treasure	Total	Merchandise	Treasure	Total
	£	£	£	£	£	£
1862	22,320,432	14,951,985	37,272,417	36,317,042	683,355	37,000,397
1863	22,632,384	20,508,967	43,141,351	47,859,645	1,111,140	48,970,785
1864	27,145,590	22,962,581	50,108,171	65,625,449	1,270,435	66,895,884
1865	28,150,923	21,363,352	49,514,275	68,027,019	1,444,775	69,471,794
1866	29,599,228	26,557,301	56,156,529	65,491,125	2,165,352	67,656,477
1867	29,038,715	13,236,904	42,275,619	41,859,994	2,431,503	44,291,497
1868	35,705,784	11,775,373	47,481,157	50,874,055	1,571,947	52,446,002
1869	35,990,142	15,155,953	51,146,095	53,062,164	1,395,580	54,457,744
1870	32,927,520	13,954,806	46,882,326	52,471,375	1,042,353	53,513,728
1871	33,413,906	5,444,826	38,858,728	56,016,408	1,801,614	57,818,022

This table shows that the total exports of merchandise and treasure from India for the ten years, exceeded the imports by about nine millions yearly. The expenditure in England on behalf of India, according to the same return, for the same period, was 77,938,188*l.*, or about seven and three-quarter millions yearly. But part of this sum must have been paid for stores which would be included in the imports; and it is only payments without present material return, which appear as exports in excess of

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The care of British trade.

Again, the expenditure of Englishmen abroad, provided for by remittances of money from England, together with the large remittances of capital for employment in foreign countries, must be large; and, the exports from England, must be proportionally greater in value, in order to provide for these remittances. This, however, does not plainly appear from the trade returns; because these returns, representing home values and not international values, exhibit a value of imports so largely in excess of exports, that any increase of exports due to those remittances, is entirely absorbed therein.

The measure of national profit.

Again, on the simple conception of exports as sales and imports as value received, it follows that an excess of value of imports affords a presumption of international profit. It is, however, only a strong presumption. The fallacy has been already shown of a merchant measuring his profit by comparison of the prices he obtains for his exports and imports respectively; the true measure of his profit being a comparison of what his exports *cost* him with what he obtained for his imports. The case of national trade is not different. Therefore, whilst the excess of value of imports affords a strong presumption of profit; the real measure of national profit can only be

imports. On the other hand, the dividends on the Indian loans paid in England by drafts on the Indian Treasury, are not included; and these would appear as exports in excess of imports. The unexplained difference from nine millions which would remain after correction on the above-stated accounts, is probably in part due to ambiguities and errors in the values. Goods subject to an *ad valorem* duty (and this is the case with many Indian imports) are likely to be undervalued.

obtained by comparison of costs of production. (See the note appended to this chapter.)

Effect on trade of alterations of demand and of cost of production.

Bearing in mind the general propositions already exhibited in this chapter, we will consider how international trade is affected by alterations of demand and of cost of production.

Let us suppose the same fictitiously simple case, as before, of England and France trading only with each other, and in one thing only from each; cloth from England, wine from France. Let us suppose, also, in the first instance, that mutual payments other than those for exported and imported goods, are equal; that there is no predominant demand on either side for bullion; and that, consequently, the exports and imports of goods effectively tend to equality in value. On these conditions, the cloth will, in effect, be paid for by the wine irrespectively of money.

Let us further suppose, in the first instance, that a bale of English cloth and a cask of French wine cost equal labour and capital in production. If the demand by France for cloth and by England for wine, were equal; the exports and imports of each country, would not only equal each other in value, as they needs must as shown above; but the value would correspond with the real cost; and one bale of cloth would purchase one cask of wine; and the trade, though attended by great benefit to both, would not be attended by 'national profit' to either one or the other.

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The effects of diminished demand by one country.

Suppose that, subsequently, by home manufacture or by any other means, the demand by France for cloth becomes positively less than before, and consequently less in relative intensity than England's demand for wine. England would then have to give more than one bale of cloth for one cask of wine. (Chap. II. Prop. 13.) It may be supposed that she has to give eleven bales for ten casks. The value of the exports and imports must be equalised (as shown above in this chapter); and the change being made by a decreased demand for cloth, the price of cloth would fall so as to make the price of eleven bales equal to the price of ten casks of wine.

Suppose on the other hand, that France's demand for cloth had become relatively less than England's for wine, not by any diminution, but by positive increase of England's demand for wine. England would have to give as in the other case more than one bale of cloth for one cask of wine. We may assume the same exchange as in the other case, viz. eleven bales for ten casks. The only difference in result would be that the change being made by an increased demand for wine, the price of the wine would rise. (Chap. II. Prop. 13.)

The relative values would be the same in the one case and the other—making eleven bales of cloth equal ten casks of wine.

It is evident that whatever the result of the two foregoing cases might be as regards the positive quantities

of exports of each country, England would give more cloth than previously for a given quantity of wine; and a profit has accrued to France by the relatively greater intensity of England's demand for wine.

It is evident also that, in any possible result of the two above-stated cases, excepting that of France actually diminishing her import of cloth, England would have exported more cloth than before in a greater proportion than the increase, in quantity, of her imports; such greater proportionate export being a sign of less profit to her and more to France. Moreover, if France imported less cloth, but by a less proportionate decrease than the decrease in her exports; such greater decrease of exports would be a sign of greater profit to her and less to England.

It is inferable that the tendencies exhibited in the foregoing fictitiously simple cases, would operate similarly in the actual complicated case of a nation's trading with many others and in many articles. The complication may make it impossible to trace the particular effect in each case; but as intensity of demand by consumers gives an advantage to the supplier; the nature of any particular article of commerce and the circumstances of the countries which import it, permit a reasonable judgment of the probable significance of any increase or decrease in the export of it.

We have now to consider the effect, as respects foreign trade, of any increase or decrease in the cost of

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production. Suppose that in the case supposed above, the cost of producing cloth is, by some means, diminished say by 5 per cent.

Effects of increase or decrease of cost of production.

The diminution of cost tends to increase supply, to lower price and to increase demand. (Chap. IX. Prop. 3, and Chap. II. Prop. 14.) Suppose that it at first decreases price to the full extent of 5 per cent. and increases thereby the demand to the same extent. The cloth must be paid for by the wine (as shown above). This therefore is equivalent to reducing the value of the wine 5 per cent. and this must increase the demand for wine. We may suppose it increased to the same extent as the demand for cloth, *i.e.* 5 per cent. The values must be equalised by reduction of the price of wine to the same extent as the price of cloth. The result is that, the decreased cost of producing cloth is shared equally by France and England ; and is felt in an equally increased consumption by each of cloth and wine respectively ; without more expenditure than before.

Suppose the increased demand for wine and cloth respectively (in consequence of diminished cost of producing cloth) to be unequal—for instance that the demand for cloth is increased by the full 5 per cent., whilst the demand for wine is only increased by 3 per cent.

In this case the diminished value of the wine (see the foregoing statement of first tendencies) not begetting an equally increased demand for wine, the exports and

imports can only be equalised in value by a relative decrease in the price of wine, *i.e.* by giving more wine for a given quantity of cloth than before. The prices which express these equal values must be equalised by either decrease of the price of wine or maintenance of the old price of cloth, notwithstanding the diminished cost of production, or partly by both. In this case England has gained more than France in the reduced cost of producing cloth, and feels the advantage in increased consumption of wine without greater cost to herself.

Similarly, it might be shown that, if France's demand for cloth were less intense than England's for wine; the reduced cost of cloth would not induce so great an increase of demand for cloth, as the consequent reduction in the value of wine, would induce of the wine; and, so, France would get more cloth for a given quantity of wine than before; and would, thus, gain more than England by the decreased cost in producing cloth.

Similarly, it might be shown that the advantage and disadvantage of any decrease or increase of cost of production, might be shared in any proportion between the two; and might, conceivably, fall wholly to one.

The distribution of the loss or gain by increase or decrease of cost of production.

It is inferable that the same tendencies would operate in the actual complicated case of trade with many nations in many things; and consequently it follows, from the foregoing propositions that,—given certain previously existing values of all articles of commerce amongst

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intertrading nations, any increased cost of production of some article, will be borne in various proportions by the intertrading nations who supply or demand it, according to the relative intensity of their mutual needs for that thing and the things given in exchange for it; and the advantage of any decrease in cost of production will accrue to the several nations in the inverse ratio.

The complications of existing international trade are so intricate, that it is not easy to give full illustration of the correspondence of these inferences with the actual facts. The opium trade between India and China, is, however, a good instance of an extreme case, in which the excessive intensity of China's demand for opium makes China bear the whole of every addition to the cost of production. Extraordinarily heavy duties thereon which, as will be shown in the next chapter, are equivalent, so far as consumers are concerned, to increased cost of production, have as yet had no effect of positively diminishing the demand, which has increased in spite of those duties; and the trade in opium is attended by an extraordinary profit to India. The export duty levied by the Indian Government on cotton manufactures is probably an instance of the other extreme. It seems to be gradually extinguishing the trade; doubtlessly because the demand is so easily affected by cost, and the supply is the subject of such strong competition, that the duty falls wholly on the producers.

All the foregoing propositions have been established

on the assumption of other payments than those on account of exports and imports, being equal; and, consequently, of the value of the exports and imports being equal. But the propositions would not be essentially altered by any change in this respect.

Suppose, for instance, that the remittances from England to France on accounts which demand no return, exceed the corresponding remittances from France to England, by two millions. The exports of England to France, must, *cæteris paribus*, be increased by two millions in consequence. If we modify the first illustrative case given above, to this supposition; it is only necessary in place of the words 'If the demand by France for cloth and by England for wine were equal' to substitute 'If the demand by France for cloth equal the demand by England for wine plus two millions payable on other accounts;' and for the words 'The value of the exports and imports must be equalised' to substitute 'The previous relative value of the exports and imports must be maintained;' and the conclusions remain unaffected.

Suppose, again, that there be a constant predominance of inflow of bullion into one country, like the flow of silver into India above noticed. It is only needful to treat the excess of bullion as being, what in such case it really is, another commodity of commerce and not mere international money; and the former conclusions are unaffected. By similar reasoning it may be inferred that the propositions, as indicating effective tendencies,

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would not be altered by the great complication of the elements of international payments, which actually exists.

Summary of principal propositions.

The principal propositions established in this chapter, are

1. Imports, generally, are value received for exports.
2. The exports of a given country must equal the imports in international value (bullion included in both cases) plus or minus the difference of the payments made and received by that country without material return.
3. An excess of home values of imports over exports is a presumption of profit to the exporting nation. But the real measure of such international profit of trade (as distinguished from the common benefit of trade) is the difference between the total cost of production of the things exported, and the total cost of production of the things received in exchange.
4. Alteration of exports and imports which increase relatively the quantities of exports, are signs of decreasing profit of trade to the exporting nation.
5. Alterations of exports and imports which increase relatively the quantities of imports, are signs of increasing profit of trade to the importing nation.
6. The advantages and disadvantages, respectively, of a less or greater cost of production of anything, is distributed among the intertrading nations accord-

ing to the relative intensity of their demands for the things exchanged; and, in proportion to the greater intensity of demand by any one, that one will bear a larger portion of any increase of cost of production, and will receive less benefit from any decrease of cost of production.

7. The national profit of trade may fall to one nation or to another or to several, in any proportion, according to the relative intensity of their several demands for the things exchanged. „

NOTE.

The following values are taken from the Trade Returns submitted to Parliament.

Value of Imports of the United Kingdoms.

	1868	1869	1870	1871	1872
Merchandise	294,693,608	295,460,214	303,257,493	331,015,480	354,693,624
Gold and Silver	24,852,595	20,500,991	29,455,668	38,140,827	29,608,012
Total	319,546,203	315,961,205	332,713,161	366,156,307	384,301,636

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Value of Exports of the United Kingdom.

	1868	1869	1870	1871	1872
Merchandise	227,778,454	237,015,052	244,080,577	283,574,700	314,588,834
Gold and Silver	20,220,014	16,377,528	18,919,690	33,760,671	30,335,861
Total . .	247,998,468	253,392,580	263,000,267	317,335,371	344,924,695
Excess of value of Imports over Exports	71,547,735	62,568,625	69,712,894	51,820,936	39,376,941

The value of the exports represents the prices at the ports of the foreign countries. The value of the imports represents the prices at which they are sold by the importing merchants (exclusive of any duty) in this country.

The large excess of value of imports is a strong presumption of great profit to England. But this excess affords a very uncertain *measure* of the profit. In the first place, the payments to foreign countries without return increase the exports, and, so, increase the significance of the excess of imports as an evidence of profit. The number of Englishmen living abroad on incomes received from home, must greatly exceed the number of foreigners similarly living in England. The remittances of capital from England for employment abroad (the return to which is only made, by degrees, as the profit

accrues thereon) must be largely in excess of any corresponding remittances *to* England. On the other hand the amount of foreign stock held in the United Kingdom, must be in excess of the English stock held abroad (because of the generally lower rate of interest in the United Kingdom); and the remittances of the dividends on foreign stock, to England, increase the imports; and therefore, *pro tanto*, diminish the significance of the excess of imports as an evidence of profit.

Again, profit, as has been already shown, does not depend upon the difference between the prices at which the things exchanged are sold, but upon the differences of cost of production. If the excess of imports in the statements above, were the *measure* of profit, it would seem that the profit had on the whole largely decreased between 1868 and 1872. The fallacy of such a comparison may be shown by a single item. The exports for 1872 include 13,198,494 tons of coal, coke and cinders valued at 10,442,321*l.*, or 15*s.* 9*d.* a ton. The exports of 1868 include 10,837,804 tons of the same, valued at 5,352,525*l.*, or 9*s.* 10½*d.* a ton. These sums represent the prices the coal obtained abroad; and, by just so much as these values exceed the cost of producing the coal, more than the values of the things received in exchange, exceeded their cost of production, is the profit to England on the coal-trade really measurable.

The consideration that a part of the difference between the values of 9*s.* 10½*d.* assigned in 1868 and

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15*s.* 9*d.* in 1872, represents a rise of wages, does not affect the national profit. It affects the merchant's profit; because, to the merchant, it is an increase of the cost of production. But to the nation the rise of wages, is only a mode in which a part of the national profit is received and expressed. If there was no increase of the quantity of labour; and, consequently, no increase of cost of producing the coal excepting the increase of wages; the whole difference between the rated values of 9*s.* 10½*d.* in 1868 and 15*s.* 9*d.* in 1872, would be additional profit to England. Yet the mode in which the increased value is exhibited in the Trade Returns, tends to diminish the apparent excess of value of imports over exports. It is thus apparent how fallacious are the exhibited differences of values of exports and imports, as *measures* of national profit.

CHAPTER XXIV.

TAXES OR DUTIES ON PRODUCE AND TRADE.

Duties equivalent to additional cost of production to producers and consumers.

ALL taxes or duties on produce are evidently equivalent to an additional cost in production, so far as the immediate producers and consumers are concerned; because, if, after making or procuring a thing at a certain cost, the owner cannot sell it without paying a certain sum to the State; that thing is produced *for sale* at so much greater cost.

Duties are not necessarily an exact equivalent to increased cost of production to the State which imposes them. To take the instance mentioned in the last chapter, it is by no means the same thing to India whether the cost of opium be enhanced manifold, as it is, by duties, or whether it be enhanced by natural difficulties.

The important questions touching the effect of any duty, are,

1. Who really pays it.
2. How it affects the demand for the commodity.
3. How it affects the direction of the industry of the community.

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How duties affect trade.

Any duty or tax, being equivalent to additional cost in production, tends to diminish demand (Chap. IX. Prop. 3). But some things are in such great request that the tendency is weak in respect to these things. In that case, the increase of cost may be met by a diminished demand for something else which can be more readily spared. So far as that is the case, we cannot doubt that the tax will be borne by the consumer of the thing taxed, because by the hypothesis, the need of the consumer prevents any diminution of his demand.

By analogous reasoning, on the other hand, if the thing be one which could readily be dispensed with, the demand might possibly be so diminished by any increase of price that the whole tax would be borne by the producers.

The incidence of duties.

It is a necessary inference from the two foregoing propositions that the eventual payment of the tax, may fall upon both producers and consumers in any proportion.

By further inference, the effect of a tax may be to diminish the consumption of the thing taxed, or of some other thing or things, or of all these, in any proportion.

Objections to taxes on raw material.

A tax on raw material is evidently more costly than a tax to the same amount on manufactured goods, by the difference of interest on the duty for the longer interval between the levy of the duty and the final consumption of the produce (Chap. XI. Prop. 4).

A tax on raw material, moreover, is much more

likely than a tax on manufactured goods, to interfere with the most desirable application of industry; because such a tax affects the manufactured products very unequally. It generally falls most heavily on the least costly productions (those in which raw material forms the largest part of the cost). These are likely to be comparative necessaries, whereas, so far as may be consistent with a tax being adequately productive, it is preferable that any inequality of incidence should be heavier on luxuries rather than on necessaries. For instance a duty of 5 per cent. on raw cotton would add about 3 per cent. to the cost of the cheaper cloths; and would, probably, not affect the price of muslins.

Export duties more costly than import duties.

An export duty must be a greater addition to the cost of production, than an import duty to the same amount, by the interest on the duty for the longer interval between the levy thereof and the consumption of the commodity (Chap. XI. Prop. 4).

In relation to export and import duties, the producers and consumers belong to different nations.

The incidence of export and import duties.

An export duty (as being an addition to the cost of production) is distributable between the one nation and the other (the producers and consumers) in any proportion, according to circumstances, as shown above, and by Chap. XXIII. Prop. 6.

An import duty, although levied after purchase from the other country, is, yet, an addition to the cost of producing the thing for consumption; and is distributable

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between the one nation and the other, in any proportion, according to circumstances, as shown above.

In short, the incidence of a tax or duty on either exports or imports, is determined by the *relative* intensity of demand for the thing taxed and for the goods for which that thing is exchanged. This may, also, be exemplified as follows.

Suppose, as in the previous chapter, the foreign trade of France and England to be limited to the exchange of cloth and wine; and that England levies an export duty of 5 per cent. on the cloth; and that this falls, in the first instance, on France by increase of price of the cloth. The values of the exports and imports on the conditions stated in the previous chapter must be equalised (Chap. XXIII. Prop. 2). France must increase the price of her wine or decrease her demand for cloth, or do both. Suppose her to attempt to increase the price 5 per cent. (the same increase as the cloth underwent). This would only equalise the values of exports and imports in the extreme case of such an irrepressible demand for wine that the increased price does not diminish the demand. In that case France would give exactly the same quantity of wine as before for the same quantity of cloth, and would be neither advantaged nor disadvantaged. The whole export duty would, in effect, be borne by England, and would necessarily be felt by England in diminished consumption of other things than wine.

In the opposite extreme case of the demand for wine being so weak that any increase of price is attended by a full equivalent decrease of demand, France would have no choice but to diminish her consumption, either of cloth or of other things, to the equivalent of the export duty; and so, would in effect, pay the whole duty; this being felt in her diminished consumption of cloth or other things.[1]

By similar exemplification, it may be shown that, if the relative demands for cloth and wine were exactly equal in intensity, an increased cost of producing one, would induce a correspondingly increased price of the other; and these would equally affect the consumption of both; and, so, the export duty would be divided equally between the two countries and be felt in equally reduced consumption by each.

Again, suppose England levies an import duty of 5 per cent. on the wine. This falls in the first instance on England. England must do one or any or all of three things;—diminish her consumption of wine; or diminish her consumption of something else; or increase the price of her cloth.

In the extreme case of France's demand for cloth being so intense that an addition of 5 per cent. to the

[1] Of course if France diminishes her consumption of cloth; this may make a contrary reaction. England, in order to keep a market for the same quantity of cloth as before, might reduce the price of the cloth. But this would only further exemplify the point, that the distribution of the duty depends upon the relative intensity of the mutual demands.

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cost would not diminish it; England might receive as much wine as before for the same quantity of cloth; and France would, in effect, pay the whole import duty, which would be felt in her diminished consumption of other things than wine.

In the opposite extreme of the demand for cloth being so weak, that any increase of price would be attended by full equivalent decrease of demand; England would pay the whole import duty, felt by her in a diminished consumption of wine,[1] or of other things or of both.

Similarly, it might be shown that, if the relative demands for cloth and wine, were exactly equal in intensity; an increased cost to the consumer of one, would induce an equally increased price of the other; and these would equally affect the consumption of both; and, so, the import duty would be equally divided between the two countries, and be felt in equally diminished consumption by each.

It is inferable that the several foregoing propositions would apply to the actual complicated cases of exchange of many things with many countries, *i.e.* that export and import duties will fall upon the intertrading nations, according to the relative intensity of their demands for the things on which the duties are levied and the things for which they are exchanged.

[1] See the note to p. 187. A corresponding note would apply to the case of a diminished demand for the wine.

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The foregoing imaginary case of two nations trading only with each other and in only one thing from each, although useful for exhibiting the international tendencies of export and import duties, keeps out of sight an important distinction between the two kinds of duty.

An export duty is much more likely than an import duty, to interfere with the most desirable application of industry; because, in so far as it falls on the producers, it falls upon a presumably small part of the community. It becomes, as it were, a special income tax on the producers. If the producers of a given thing make a profit of 20 per cent. out of the selling price, a duty of 5 per cent., if it fell entirely on the producers, would be a 25 per cent. income tax as regards their income from that particular production. Of course, the case of a duty falling entirely on the producers, is an extreme and an unlikely case. But if 4 per cent. were paid by the consumers and only 1 per cent. fell upon the producers; this, in the supposed case, would be a 5 per cent. tax on the income from the produce, besides the loss attending a probably diminished demand.

It is thus easily understood, how a duty, very moderate so far as it falls upon a whole people, may suffice to almost extinguish the particular industry on which it falls; if circumstances make it fall principally on the producers.

On the other hand an import duty falls primarily on consumers, and only affects each in proportion to his

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consumption of the particular commodity. Of course, as shown above, the import duty may react so as to be borne in part, or conceivably altogether, by the producers. But in most cases the nation which levies the import duty, is not the only consumer; so that the import duty, even so far as it falls on the producers, is only an addition to the cost of a part, not of the whole, of the produce.

A general inference from the foregoing considerations is, that an export duty can only be advisable in the case of commodities for which there is an almost irrepressible demand.

Advantage of taxation falling on consumption rather than on production.

A further general inference is that, in imposing any tax on produce or trade, it is desirable that it fall immediately upon consumption rather than on production; or, to speak strictly, on capital devoted to consumption rather than on capital devoted to production.

All taxation of articles of commerce tends to diminish production on the whole.

In conclusion, all taxation of articles of commerce, excepting in the rare case of the taxes being applied to some other reproductive purpose, must diminish production on the whole; and must, therefore, be a direct loss of productive power to some; and an indirect loss to all concerned; although some may gain directly more than they lose indirectly. No two cases are exactly alike. It is the province of the statesman to consider the probable result of all the tendencies, according to the circumstances of each case.

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Summary of principal propositions.

The principal propositions established in this chapter, are as follows.

1. A tax on produce is equivalent to increased cost in production.
2. A tax on produce, if not applied to reproductive purposes, diminishes production and consumption on the whole.
3. A tax on produce will diminish the consumption of the thing taxed, or of some other thing or things, or of all these, in any proportion, according to the relative intensity of demand for the various kinds of produce.
4. A tax on raw produce is more costly than a tax, to the same amount, on manufactured goods, by the difference of interest on the tax for the longer interval between the levy of the duty and the consumption of the produce.
5. A tax on raw produce is more likely than a tax on manufactured goods, to hinder the most desirable application of industry.
6. An export duty or import duty, will, eventually, fall upon the one nation who levies it, or upon any one or more of the nations who trade with the nation who levies it, or upon all, according to the relative intensity of their demands for the things on which the duties are levied and the things for which they are exchanged. In proportion to the greater intensity of demand by any one nation, that one will

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bear, eventually, a larger proportion of any duty, a proportion which might, conceivably, be the whole.

7. An export duty is more costly than an import duty to the same amount, by the difference of interest on the duty, for the longer interval between the levy of the duty and the consumption of the produce.

8. An export duty is specially likely to interfere with the most desirable application of industry, unless imposed on commodities in almost irrepressible demand.

9. Taxes which fall on capital devoted to consumption are generally preferable to those which fall on capital devoted to production.

CHAPTER XXV.

FREE TRADE AND PROTECTION.

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The meaning of the term 'Free Trade.'

THE term 'Free Trade' has acquired a special technical sense as representing a policy or a principle. It is nevertheless often used very loosely. The study of political economy has done so much to remove the restrictions on trade; that 'Free Trade' has become an accepted maxim or a watchword, used by many who could not give a perfectly consistent account of what they mean by it. Public discussion offers frequent instances of the fallacy of ambiguity, by which it is supposed that, if the word 'free' be applicable, in any sense, to a given measure or policy affecting trade; that policy can claim the principle of free trade in its favour. For instance, the advocates of the removal of the duties on tea and sugar, lately embodied their demand in the cry for 'a Free Breakfast-table;' and it was often, in consequence, assumed that the measure was demanded by the principles of free trade. If free trade means freedom from all taxation, the assumption was right; and it has that meaning in the mouths of some. The question of its proper meaning, is the question of what is the sense in which the most

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accurate writers and speakers use it; and, if there be a tendency to ambiguity, it must be admitted that it is desirable to withstand that tendency.

Origin of the term 'Free Trade.'

It is a matter of historical fact that the name 'Free Trade,' as the name of a policy, arose in opposition to the policy of 'Protection,' the policy of protecting home production against the competition of foreigners in similar production. The protection was sometimes by the absolute prohibition of import of foreign goods, as was the case in Great Britain in the last century in respect of woollen cloths till the year 1816 (cloths made in Ireland were excepted); and in respect of cattle, sheep and swine until the year 1842. Sometimes the protection was by bounties paid on the export of home produce. Bounties were given in Great Britain on the export of corn until the year 1814. Bounties to support some of the fisheries of this country were given at a fixed rate per ton of the tonnage of the vessels employed in the trade. But most commonly, the protection was by means of import duties levied on foreign goods, such as the duties on foreign corn imposed by the Corn Laws, which endured until the year 1846, and which had been, for so long, the principal subject matter of the dispute between 'Free Trade' and 'Protection' in England. The Navigation Laws, which endured until 1848, were analogous to prohibitions of import. These laws allowed certain goods to be imported to Great Britain and to its colonies only in British ships or ships of the country

The nature and examples of protective measures.

The Navigation Laws.

whence the goods were produced or exported. Trade between different parts of the British empire was restricted to British ships. The law also required that the master and three-fourths of the crew of every British ship, should be British subjects.

The motives of protection.

Doubtlessly, the ordinary short-sighted selfishness of each class concerned, has been a powerful motive to the policy of protection. Nevertheless, a policy which endured for so long with such general approval, and which is by no means yet everywhere obsolete, must have been supported by more general notions. It seems probable that the principal notions of general benefit which have underlain protection, are

1. That it is an advantage to a nation to be independent of foreigners for supply of any of its needs; because the foreigners might withhold the supplies in case of war or on other provocation. (This notion seems to have been the most enduring. See Hansard's 'Parliamentary Debates' of 1846. Corn Laws, *passim*.)

2. That by providing more numerous employments for a people with the assured remuneration which protection gives, protective measures increased their means of obtaining a livelihood, and generally strengthened the national resources.

3. Protection was supported by what is known as 'the Mercantile System,' which measured the wealth of a nation by the import of the precious metals; and which consequently regarded exports as increasing, and imports

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as decreasing, the national wealth (see Adam Smith's 'Wealth of Nations,' Book IV. Chap. I.).

Other special considerations supported particular cases. For instance it was supposed (see the 'Parliamentary Debates' in 1846) that the Corn Laws beneficially maintained a comparatively steady price of corn. Those who held this opinion did not perceive the law (Chap. IX. Prop. 7) which keeps a fall in the value of corn, limited by the cost of production of the most costly portion of the supply.

As another instance of special considerations in favour of protection, the Navigation Laws were supposed to maintain the naval supremacy of Great Britain by securing a larger supply of English ships and seamen (see Adam Smith's 'Wealth of Nations,' Book IV. Chap. II.). Judging by the result, we see that the supposition was erroneous; because England's great facilities and aptitude for maritime trade made the extension of her shipping accompany all extension of commerce; and consequently, so far as the Navigation Laws, by increasing the cost of sea transit, restricted commerce; they must have restricted rather than increased England's naval resources. But our better apprehension of political economy and larger experience, do not seem to make it inconceivable that a protective policy should be effective for such a special purpose which is not directly connected with production exchange or distribution of wealth.

Of the more general notions above stated, the first,

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Protection as a means of independence of foreigners.

viz. independence of the effects of the hostility or jealousy of foreign nations, cannot be regarded as wholly false in former days when the means of international traffic were very limited and precarious. The notion, however, became more and more fallacious under the actual circumstances of society; and as the facilities of trade have become greater, it has come to be accepted, in this country at least, that there can be no advantage to a nation in making for itself anything which it could obtain more easily or abundantly from other people, by exchanging some other of its own produce for it.

The second notion above stated, that protection by providing more employment for a people increased their means of livelihood and strengthened the national resources is a complicated one.[1] It might be supposed to do this in two ways. Firstly, by providing work for those who would otherwise be idle. Secondly, by securing better remuneration for work.

[1] The following preamble of a protective Act of Elizabeth's reign (5 Eliz. cap. 7) affords a good example of this notion:—'Whereas, heretofore, the artificers of this Realm of England, that is, to wit, girdlers, cutlers, saddlers, glovers, point makers and such-like handicraftsmen have been in their said faculties greatly wrought and greatly set on work, as well for sustentation of themselves, their wives and families, as for a good education of a great part of the youth of this realm in good art and laudable exercise, beside the manifold benefits that by means or by reason of their knowledges, inventions and continual travel, daily and universally come to the whole estate of the commonwealth of this Realm; yet, notwithstanding, so now it is that by reason of the abundance of foreign wares brought into the Realm from parts beyond the sea, the said artificers are not only less occupied and thereby utterly impoverished, the youth not trained in the said sciences and exercises, and thereby the said faculties and the exquisite knowledges thereof, like in short time within this Realm to decay; but also

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Protection as seeming to give more employment to a people.

The idea that protection found work for those who would otherwise be idle, was supported by actual experience of the tendency of foreign competition to throw out of work, some who would not well know to what to turn their hands. A larger experience, after the withdrawal of all protection, now tells us that this was to mistake a temporary inconvenience incidental to a transition state, for a permanent consequence; that under ordinary and free conditions there is always work demanding labour; and that the most economical direction of labour will be attained more effectively, by leaving it to self-adjustment, than by protective measures.

Protection as seeming to secure a good remuneration to labour.

Again, protection seemed to be advantageous in securing a good remuneration to labour; because protection keeps the price of a commodity higher than it would otherwise be. Although the nation, as a whole, could not be the richer for this; it might seem as if the portion of the nation employed in producing the protected commodity, were the richer; and that, so, a better distribution of the national wealth ('better' in the sense of securing the labouring class from extreme poverty) is secured; though at the cost of some diminution of the total wealth of the nation. But, excepting so far as the protective measures keep up the price by artificially

divers cities and towns within this Realm of England much thereby impaired, the whole Realm greatly endamaged and other countries wholly enriched and the people thereof well set on work to their commodities and livings, in the arts and sciences aforesaid, and to the great discouragement of skilful workmen of this Realm, being in very deed nothing inferior to any stranger in the faculties aforesaid: For reformation whereof,' &c., &c.

restricting the supply; the great probability is, that the profit will not exceed that of other industries (Chap. IX. Prop. 6 and Chap. XIV. Prop. 3); and the high price will only represent greater cost of production, not larger wages or profits to the producers. So, without reduction of supply, there is, really, no gain even to the particular class, to set against the general loss which must attend the procuring of anything at a greater cost than is necessary.

Protection inoperative to secure a better remuneration of labour, excepting at the cost of an inconvenient restriction of produce.

It thus appears that, as a means of securing a more equal distribution of wealth, protection would be inoperative, excepting at the cost of such restriction of supply as would be a grave inconvenience to the whole community.

It may be thought that these objections to protection hold good, so long as the whole supply of anything is obtainable better from abroad; but that it would be otherwise, if a part of the supply be inevitably produced at home, as in the case of agricultural produce and many other industries. It might be thought that protection is needful to prevent the foreign competition lowering the price below the remunerative limit to the home producer. The law (Chap. IX. Prop. 7) that *if one kind of produce be produced under various conditions so that, under some, the cost of production is less than under others; the value of the whole tends to, and cannot be permanently less than the cost of production of the most costly part*, secures a remunerative price to the producer,

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so long as it is really necessary that a portion of the supply be produced at home. In case of home producers struggling to exist against a foreign supply which really supersedes the necessity for any home supply, as, for instance, the Spitalfields silk weavers struggled against the foreign silk trade, an unremunerative price must be inevitable.

The mercantile system.

The third general notion above stated, and once so prevalent, that the wealth of a country consisted of its gold and silver, and that it was of first necessity to prevent the export of these metals, was at all times false. It was founded on the mere illusion caused by the universal use of those metals as the measure of value and medium of exchange. The notion that it was needful to retain a certain quantity of these metals in the country, was true. They were needed as a medium of exchange. But the notion of the nature of money, and the consequent notions of the means and desirable limits of the retention of gold and silver, were wholly false. Men did not perceive the relations of quantities of gold and silver to prices, or that, as shown in Chap. XXIII., a constant outflow of these metals would, by scarcity, so raise their value in the given country, that they would inevitably come back from abroad to so good a market.

Other kinds of protective laws.

There are other kinds of protective laws, viz. such as those which in the legal and medical professions, restrict competition and regulate remuneration; and the self-imposed protective laws which unions of workmen

adopt to restrict competition and for other ends. These, however, will be best treated in a future chapter on 'Co-operation.' CHAP. XXV.

Such being the nature of protection, as above shown, free trade, as the negation of it, is simply the principle (Chap. VIII. Prop. 5, and Chap. XXII. Prop 1) that the wealth of all is increased by each part of the whole inter-trading community being occupied in producing that which it is most fitted to produce. France needs certain cloths and England needs certain wines; and if it be found that each can procure these most cheaply, by France supplying the wine and England the cloths, because of the natural or acquired facilities of the two countries for the respective productions; it would be wasteful for either of these countries to attempt, by protective measures, to be independent of the other. 'Free Trade' in its general meaning, as opposed to 'Protection,' only means the application of this conclusion in all analogous cases. It does not proscribe duties imposed for the sake of revenue; unless those duties be such as would prevent the use of the otherwise fittest means of production; so that they would become, in effect, protective duties. We believe that this is the proper meaning of the term 'Free Trade;' proper, both as being the sense in which alone accurate thinkers for the most part, at present, use it as a technical name; and as being the sense beyond which it cannot be extended without inconvenient ambiguity. The principle of free trade.

So much benefit has attended the policy of restrict-

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Tendency to extend the meaning of the term 'Free Trade' objectionably.

ing custom and excise duties to a few commodities of general consumption; so freeing all other trade from the inconveniences attending the levy of such duties; and this policy has been so associated with free trade; that there is a tendency to extend the name 'Free Trade' to a very different policy, the policy of freeing all trade from taxation. As no one (excepting those who would impose restrictive duties on certain trades for moral considerations) doubts the advantage of this, if the revenue could be dispensed with; the policy is, in effect, the exclusive use of direct taxation. The considerations which are opposed to this policy, will be shown in the chapter on 'Taxation.' The great majority of men in England at present, entirely accept the principle of free trade in the primary sense above stated. Probably a nearly equal majority rejects the principle in the other sense. The inconvenience of one name for two principles so different in their nature and in the degree of their acceptance, is plain.

CHAPTER XXVI.

TAXATION.

Nature of taxation.

TAXATION is the process by which the several members of a community are made to provide for the expenditure which is undertaken by the governing body, on behalf of all. The community may be a whole nation, or a section thereof such as the inhabitants of a township. In other words, the taxation may be imperial, municipal, or otherwise local; but the principles which should regulate it, are the same in each case.

Direct and indirect taxation.

Taxation is levied either directly or indirectly. An income tax, a poll tax, a tax on the exercise of professions or trades, on the use of horses or dogs, and such like, are direct taxes; *i.e.* a certain sum is levied from a certain person. Taxes on exports and imports (usually called custom duties), and taxes on home produce irrespectively of exportation (commonly called excise duties), are indirect taxes; because no one is compelled to pay a fixed portion of it. The tax is only felt in increased prices of certain things.

Assuming the sum of taxation to be determined by real State necessity, it is plain that the only sense

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in which one mode of taxation is heavier or lighter than another to the whole community, is that one may be either directly more costly in collection, or indirectly more costly by interfering with some profitable industry.

Desirable conditions of taxation.

Consequently, the desirable conditions of taxation, are

1. That it fall in due proportion upon all according to their means.

2. That it hinder production as little as possible.

3. That it be as little difficult and costly in collection as possible.

Simple as these principles seem, their combination presents most difficult problems.

Direct tax according to means.

It might, at first sight, appear that, according to the foregoing conditions, an income tax, regarded as a tax according to means, would be the best of all. But the levy of it on all the poorer classes would be quite inconsistent with the third condition of avoiding difficulty in collection. Such a tax, therefore, as actually levied, favours the poor.

Indirect taxes on articles of general consumption.

It might be thought that an indirect tax on articles of general consumption fulfils the desired conditions more nearly than most. But, in some cases, the rich man's consumption of these things, does not exceed the poor man's consumption in the same ratio as his means exceed those of the poor man. In this case the tax favours the rich. The more nearly such a tax approaches

to a necessary of life, the more is its incidence likely to favour the rich ; as for instance, a duty on salt.

Effect of general taxation of all articles of consumption.

With the foregoing considerations in mind, it might seem that an equal tax upon almost every article of consumption according to its value, would be a very equitable mode of taxation. But this would be attended by great cost in collection and great hindrance to trade, to the injury of the whole community.

Every convenient form of taxation open to objection of some inequality in incidence.

In short, there is no convenient and practicable form of taxation which is not open to the objection of some inequality in its incidence. The statesman has to make the best compromise he can, between the conflicting claims of equality and convenience ; and, if one kind of tax favours one part of the community and another tax the other part ; the adoption of both may, sometimes, be a reasonable solution of the question.

Moreover, although the three conditions above stated, are the elements of just and economical taxation ; yet the statesman has sometimes to consider a fourth condition, viz. how far one kind of tax is, on the whole, preferred by those who have to pay it. For, men reason so imperfectly on such matters ; or allow appearances so to overbear the conclusions of reason ; that they will often prefer a heavier taxation which is concealed by an indirect mode of levy, to a lighter levy whose weight is distinctly perceptible.

All the propositions in Chap. XXIV. bear upon the present question of the preferable means of taxation.

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Peculiarity of local or municipal taxation.

Municipal or local taxation has, often, a peculiarity not shared by imperial taxation in that it is levied separately for specific purposes, such as water supply, lighting, road repairs, drainage and such like. This circumstance raises questions of whether one class of the community receives more proportional benefit therefrom than another; and, so, modifies the practical application of the principle of equality of incidence.

Example of the many difficulties and disputable theories touching taxation.

This subject offers, in detail, many intricacies beside those which the foregoing observations directly suggest. There is much dispute as to what are a man's 'means' as a subject of taxation. It is urged that what is necessary for his maintenance is no part of these 'means.' As an abstract proposition, it must be admitted that what is absolutely necessary for maintenance cannot be diminished without proportionally extinguishing the means of taxation. But in this strict sense, the line of necessity cannot, practically, be drawn. This one instance may suffice to suggest how many are the disputable theories touching the conditions of perfectly just incidence of taxation; and to show that the broad and brief treatment of the matter in this chapter, is adopted as most consistent with the purpose to exhibit only elementary laws, and not in ignorance of the manifold and important considerations which attend their application.

CHAPTER XXVII.

BANKING.

FOR the apprehension of some problems touching money, it is necessary to apprehend clearly the elements of banking.

The basis and uses of banking.

As each wealthy man receives his income at times and in quantities different from those of his expenditure, he necessarily keeps some quantity unemployed, in order to meet his liabilities of expenditure. This quantity may be called a 'reserve.' If each kept his own reserve; the average sum of all these reserves would be withdrawn from use as a means of exchange. Moreover, owing to the frequent changes in the employment of money, there are always, beside these reserves, varying quantities unemployed during the intervals between their release from one employment and investment in another. The average sum of these would also be withdrawn from use, if they were kept by their several owners. These quantities may also be conveniently classed with the reserves.

As all persons do not need to draw on their reserves at the same time; it is evident that, if many throw their

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reserves together, a smaller sum suffices for securely meeting their aggregate needs, than would be required if each kept his own separate reserve. The banker, by undertaking to keep the reserves of many, obtains the use of the quantity by which the sum of the several reserves exceeds the needs of the case when they are thrown together. By this arrangement, the bankers, the depositors and the whole community are advantaged. The bankers are advantaged by the use of the available surplus which they lend at interest. The depositors are advantaged by the services of the bankers, not only in responsible safe custody of their reserves; but also in keeping the depositors' accounts; making payments for them; receiving sums due to them; and giving other such services which would be troublesome and costly to the several depositors. The community is advantaged in two principal ways. Firstly, the bankers in lending the available surplus, help, in an important degree, to distribute the use of capital to the most effective hands; and secondly the banking operations free a portion of the valuable commodity (gold or silver) used as money, for use either as a commodity or in foreign trade. They do this in two ways; by making the necessary reserves less than they would otherwise be; and by substituting payments by cheques and other analogous means, for payments by actual money.

The conditions of banking

With reference to the statement that the banking operations free a portion of the gold for use in foreign

trade; the inquiry may be supposed, whether they do not equally free it for use in internal trade? They do so; but with no advantage except in relation to foreign trade. To explain this, let us suppose a country without any foreign trade. The money so freed for use in exchange, could, as money, only raise prices (Chap. X. passim); and, consequently, the society would not be benefited, excepting so far as more money might happen to be a convenience; and so far as the gold is needed for other purposes than money. But when the country has a foreign trade, the gold spared from internal circulation is so much additional capital because exchangeable abroad for additional capital.

As the banker is liable to a demand of the whole of each man's reserve at any time; and as, under certain circumstances, such demands upon him, may enormously exceed the average; the only condition on which the banker can employ the excess over the ordinary demand, is by lending it in such a manner as secures either repayment on demand, or repayment within periods so short that, when an unusual demand to withdraw deposits begins or appears likely, it can be met in ordinary course, by the return of the loans as they fall due.

Consequently the bankers can only lend the money to those who already have the command of equivalent capital convertible into money; or who have equivalent capital due to them within short periods; or who can be trusted to employ the capital which the money com-

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mands, in ways reproductive within short periods. If they cannot do this, the money must remain idle. The money is not idle like hoarded money in the sense of serving no purpose whatever. It answers the purposes of reserves to those who deposited it. But it is idle as a medium of exchange.

It is further evident that larger reserves must be needed when credit is small than when credit is large, because credit dispenses proportionately with the need of money.

The general character of banking.

The general character of banking is, therefore, a general economy of the gold (or other valuable commodity used as money) by making a smaller quantity suffice as reserves and a smaller quantity suffice for internal circulation. It is also a general economy of capital, by facilitating the distribution of capital to the most effective hands; as well as by converting a portion of the gold into available capital.

There are various modifications of banking operations in actual practice; but the foregoing statements represent their whole elementary character.

Summary of principal propositions.

The following are the principal propositions in this chapter.

1. The advantages of banking are—
   (1.) The diminution of the quantity of money unused except as a reserve.
   (2.) The liberating for use as a commodity or in foreign trade, a portion of the precious

metals which would otherwise be used as money for internal exchanges.

(3.) The distribution of capital to the most effective hands.

(4.) The convenience of depositors, in the safe custody of their reserves, in making payments for them and receiving sums due to them; and in other such services.

2. The bankers can only lend the deposits to those who have command of equivalent capital; or who have equivalent capital due to them within short periods; or who can be trusted to employ the capital which the borrowed money commands, in ways reproductive within short periods.

3. As general credit is enlarged, the needful reserves (balances held by bankers) are smaller. As general credit is restricted, the needful reserves are larger.

CHAPTER XXVIII.

CURRENCY.

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Definition of 'Currency.'

COMMON use and convenient distinction seem concurrent in designating by 'Currency,' *whatever is a legal tender as money*, to the exclusion of things which, though effective as money, are not a legal tender, as, for instance, the notes of many provincial banks which no one is compelled to accept as money.

In order to simplify the elementary consideration of currency, we will suppose the case of gold coin being the only legal tender.

Gold is the money of the European world. Therefore, all which can be spared from use as currency in a given country, is, virtually, capital to that country; because always exchangeable for capital from abroad.

We will consider what is, in fact, done with all the gold in a given country, say in England.

There is so much used for plate, for ornaments, and as an useful material for many other purposes. This quantity so used as a mere commodity, may be at present disregarded; because there is no reason to suppose that this quantity is at all affected by the temporary fluctua-

tions of the trade in gold. The quantity which is *uselessly* hoarded, may be disregarded for the same reason. Of the remaining quantity, some is used as money for the internal exchanges; some is used as money for the adjustment of foreign exchanges; and some is used as 'reserves' of money, as defined in Chap. XXVII. There are no other purposes to induce the retention of gold in the country. We may be sure, therefore, that any quantity altogether in excess of these needs, would be sent out of the country in exchange for commodities or for foreign investment.

We have to consider what regulates the quantities needed for the foregoing purposes.

How the quantity of gold needed for internal exchanges is determined (on the supposition of gold being the only currency).

First, as respects the quantity needed for internal exchanges. It was shown, in Chap. X., that, for purposes of large comparison, such as of prices in one century and another, there is, at any given time, an approximate standard or average of prices measured by gold, which depends on the quantity of gold in the intertrading world. This standard is the result of much tentative bargaining, through long periods. It may be undergoing a gradual increase or decrease, measurable by comparison of average prices at long intervals. But at any given time, with respect to the temporary fluctuations of the gold market, the standard may be regarded as constant. In other words, any general rise or fall of prices within such short periods, is due to temporary causes, and is unconnected with any general decrease or increase

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of the quantity of gold in the intertrading world. This statement accepted (on the grounds stated in Chap. X.); it follows that the quantity of money needed at any given time, for internal exchanges, must, *cæteris paribus*, depend upon the number of transactions and the prices. (This indeed is the equivalent of Prop. 3, Chap. X.); and that the increase or decrease of money in circulation attending an increase or decrease of transactions, is in order to *keep* prices at the standard, and cannot tend to alter prices.

The quantity of gold in circulation adjusts itself to needs, and cannot be artificially increased.

It follows also that the quantity of currency required for internal circulation, adjusts itself, *cæteris paribus*, to the number of transactions, by what may be called the natural operation of the need for money to transfer commodities. The quantity of gold in internal circulation, cannot be artificially increased, as was shown in Chap. X. Additional gold can only be put in circulation, by offering it in exchange for commodities. Additional gold so offered, when there is no corresponding addition to the quantity of commodities, could only raise prices, so as to make such use of additional gold unprofitable.

A temporary inflow or outflow of gold, does not necessarily affect prices.

Hence, it follows that a large quantity of gold flowing into the country, does not necessarily raise prices; nor a large quantity flowing out, necessarily lower prices, and experience confirms this. The immediate effect is an increase or decrease of the reserves; which is not necessarily followed by an alteration of the quantity in circulation. Consequently, the law that more money makes

higher prices and less money lower prices, is not applicable to the reserves. This also was shown in Chap. X.

How the quantity of gold needed for foreign exchanges, is determined.

The quantity of gold required for foreign exchanges, is a fluctuating sum depending on the balance of exchanges. It was shown in Chap. XXIII. that, certain cases excepted, the receipts and payments of bullion (used as international money) by any one country must, in the long run, balance each other; and if they did so constantly, no gold would be needed; because immediate payments are made by bills; and the gold is only sent to pay the differences. When the difference is an excess of payments due *from* foreign countries; the difference must be paid in gold causing an inflow of gold. When the excess is of payments *to* foreign countries; there is an outflow of gold. The inflow increases the reserves; the outflow diminishes them.

How the quantity of gold needed for reserves is determined.

The quantity of currency needed for reserves, is also a fluctuating sum. The need is greatest when credit is least; and, therefore, when the quantity of available capital is least abundant. It is least when credit is greatest (Chap. XXVII. Prop. 3).

The rate of interest may rise or fall without affecting the quantity of money in circulation.

When the quantity of reserves is increased beyond what is felt to be needful, the holders (the bankers) immediately desire to lend the superfluous reserves; and in proportion to the quantity of money so offered, by bankers, on loan, money is said to be abundant and cheap. This does not mean that prices are altered, or that capital is necessarily abundant. It may be that it

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is because capital is scarce that the reserves of money are large. It only means that the bankers have plenty to lend because their customers have large reserves; and that the rate of interest is, in consequence, low.

Similarly, when the reserves are diminished below the quantity felt to be desirable, the holders are unwilling to lend, and the rate of interest is high.

These consequences may have no effect on prices; because we see them take place without affecting the quantity of money in internal circulation (see note to page 66).

The interest of money may be low whilst capital is scarce.

It is very needful to apprehend this clearly, how money may seem plentiful when capital is scarce; and to understand the sense in which it is considered plentiful. Because, money plentiful while capital is scarce, is a seeming contradiction to the law that money increases and decreases as capital increases and decreases; and is, seemingly, inconsistent with the character of money as the representative of capital.

In the language of the money market, a 'scarcity' of money means a greater demand to borrow than to lend; and 'plentifulness' means more offered on loan than demanded by borrowers. The loans of money are necessarily made from the reserves. These loans (as shown Chap XXVII. Prop. 2) can only be made to those who have, in some way or other, equivalent capital or equivalent credit. Consequently when capital is scarce, and credit consequently scarce; both the qualified bor-

rowers may be few and the use of money (to exchange capital) restricted. The bankers may have difficulty in finding customers; and offer their loans at low rates. In this sense money may be cheap and plentiful. It is not that there is actually more of it; but that there is less use for it. There is less capital to be exchanged by means of it.

The interest of money may also be low when capital is abundant.

Again, when capital is plentiful and credit plentiful; money may still be 'cheap,' both because of the tendency of money to flow into the country when capital is abundant (Chap. XVI. Prop. 9), and because credit supplies the place of money in circulation, and because money is virtually lent in the form of credit. Thus we see that money may be cheap (the rate of interest low) both when capital is abundant and when it is scarce; and how is this reconcilable with the character of money as the representative of capital?

Explanation of how the interest of money may be low both when capital is abundant and when it is scarce.

The explanation evidently lies in the distinction between money in reserves, and money in circulation. It is only the latter which represents capital. When capital is abundant, the money (and credit which represents it) is really abundant; and may be lent cheaply. When capital is scarce, the bankers' attempts to lend their reserves, may be really attempts to force more money into circulation than is needed; and so the loan of reserves may be offered cheaply.

In Chap. XVI. Props. 7 and 8, it was shown that if the capital in any country be diminished, the things perform-

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ing the normal function of money within that country, will fall in value; and so far as that fall extends beyond the diminution of credit, to the depreciation of gold or silver money; it will cause the gold or silver money to be either hoarded or sent out of the country.

And again, that if the capital in any country be increased, the things performing the normal function of money within that country, will be increased in value; and so far as that increase extends beyond the increase of credit, to an enhanced value of gold or silver money, it will cause the gold or silver money to be brought out of hoards or to flow into the country from abroad.

These propositions will now be more perfectly apprehended in the light of the above-stated elementary considerations touching currency. The accumulation of money in reserves is equivalent to temporary hoarding. It seems to take place to a large extent from two principal motives. Firstly to await a more favourable time for employing the money; and secondly because the reduction of credit makes everyone to need larger reserves.

Convertible bank notes are equivalent to a purely gold currency.

The foregoing statements are made on the assumption of gold coin being the only currency. It is evident that bank notes which are a legal tender, are, according to the definition, currency. So far as such notes are issued in place of gold which can be used for no other purpose than to exchange for the notes; the notes are equivalent to a purely gold currency.

It was said above that, on the assumption of a purely gold currency, the quantity of money in circulation for internal exchanges cannot be artificially increased. It follows that, so long as notes are exchangeable for gold at pleasure, the quantity of notes in circulation cannot be artificially increased. Of course, if the State makes inconvertible notes a legal tender; there is no limit to the possible increase of the quantity in circulation, as shown in Chap. XVII.

Summary of principal propositions.

The elementary considerations touching currency established in this chapter are on the supposition of a gold currency or a currency partly gold and partly notes exchangeable for gold at pleasure.

1. The whole currency may be regarded as comprising three quantities.
   (1.) The quantity needed for internal exchanges.
   (2.) The quantity needed for transacting foreign exchanges.
   (3.) The quantity in reserves.
2. The quantity in internal circulation adjusts itself to the number of transactions at the existing prices by the natural operation of the need of money to transfer commodities.
3. The quantity in internal circulation cannot be artificially increased.
4. The quantity in internal circulation is not necessarily affected by an outflow or inflow of gold from or to the country.

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5. Any quantity of gold flowing into or out of the country, affects the reserves; and the redundance or deficiency of these reserves makes money abundant and the rate of interest low, or money scarce and the rate of interest high, respectively.
6. The law that more money makes higher prices and less money lower prices, is not applicable to the increase or decrease of reserves; because it is only money which is actually in circulation (actually offered in exchange for commodities), which affects prices.
7. Money accumulates in reserves beyond the average in order to await more favourable opportunities for employing it; and also when a diminution of credit makes everyone need larger reserves.
8. Interest of money has no connection with other prices.
9. Fall and rise of the rate of interest do not necessarily correspond respectively with abundance and scarcity of capital.

CHAPTER XXIX.

POPULATION.

Tendency of increase of population to increase the general wealth.

WE have to consider how the natural tendency to increase of population affects the production and distribution of wealth. From the fundamental assumption (Chap. II. Prop. 3) that under ordinary circumstances men can produce more than they necessarily consume in the process of production, it is evident that one tendency of increase of population is to increase the wealth of the community. It was shown in Chap. VIII. how production can be indefinitely increased by applying spare labour to provide means of increasing the produce of a given quantity of labour. The actual development of this tendency by the aid of machinery, has been immense; and it may be extended indefinitely further. The population of Great Britain has more than doubled in this century; and there can be little doubt that the produce of the nation is equivalent to a much larger sustenance in proportion to numbers than at the earlier periods. We say 'equivalent to a much larger sustenance.' Judging by the scale of food of the labouring classes, it seems likely that the produce does actually provide a larger

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sustenance in proportion to population, than at many previous periods when population was less. But, independently of the foregoing supposition, the important point is, that much of the produce of the nation which is spent in procuring things which do not help, or help little, to sustain life, could be exchanged for food if necessary. We include this in saying that the produce is *equivalent* to a much larger sustenance. There seems no reason to doubt that it is the same, on the whole, in other countries; viz. that the increase of population has not been attended by a decrease of the resources for sustenance in proportion to numbers, but rather by an increase.

The ultimate limit of the tendency of increase of population to increase wealth.

It is plain that the only absolute limit to this increase of population without diminution of the wealth of the community in proportion to numbers, is the exhaustion of the supply of land. The constantly increasing facilities for commerce and emigration, *i.e.* for import of food and export of labour, seem to make the time indefinitely distant, at which this limit will be felt by society as a whole. On the other hand, nearly everyone is personally cognisant of much poverty and suffering due to multiplication of human beings without ready and adequate means for their support. There are tens of thousands who, from this cause, are living in conditions describable as 'misery.'

Explanation of erroneous

In consequence of two erroneous inferences from the facts above noticed, there is often much misapprehension

of the question of the effects of increasing population. Some infer that, because a large part of the poverty we see around us, is due to imprudent multiplication of numbers; the community would be wealthier (production would be greater in proportion to numbers), if the population were smaller. It is far from being a necessary inference. It would only be such, if the poverty were due to an actual deficiency of the general means of getting food; and this, certainly, is not the ordinary case throughout the world, at present.

suppositions touching increase of population.

Some, on the other hand, infer that, because the general wealth has not been diminished; but rather increased by increase of population; the poverty of particular classes cannot be the consequence of increased numbers.

Increase of population affects unfavourably the distribution of wealth not the production of it.

The fact is that the misery due to increase of population, is caused by the effect of the increase on the distribution of wealth, and not on the production of it. Moreover, this effect on distribution, is irremediable, excepting by removal of the improvidence which caused it. Man can do little to support himself during many years of youth; and just as the single adult man is absolutely dependent upon previously stored capital, for the means of existence from day to day, or from season to season, whilst earning wages or producing food or things exchangeable for food; so, all men, for several years of childhood, are absolutely dependent upon capital supplied by others. If parents have not a sufficient share of the general wealth to support their children;

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these inevitably suffer, be the general wealth of society ever so great. For, if the improvident could throw on others the support of their families, making the rest of the community bear the consequences of their improvidence, the motives for individual industry would be so weakened, that we might expect society to lapse gradually into the extremest poverty consistent with existence; *i.e.*, such would be the consequence on the supposition of society continuing to undertake the support of all children thrown on it, and yet leaving everyone free. Of course, in reality, any such experiment would soon be ended either by society repudiating the responsibility or by compulsory labour.

Poverty not ordinarily caused by any inevitable insufficiency of food.

Therefore, how great soever may be the wealth of the community, each individual and each class must suffer by its own improvidence; and the poverty which we see has little or nothing to do with any inevitable insufficiency of food in relation to population.

Poverty and its miseries not remediable by mere social system.

Doubtlessly, within certain limits, the degree of such poverty may be affected by social system; and, so, many persons, seeing that the actual poverty experienced by multitudes, is a consequence of unequal distribution of wealth, not of general insufficiency, conclude that it is altogether remediable by social system. This however is the hopeless notion that mere administrative system can extinguish idleness and improvidence and its consequences. This subject will receive further consideration in the next chapter.

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Sufferings attending poverty much aggravated by density of population.

The foregoing remarks must not be misunderstood, as if it had been said that no portion of the misery attending poverty is due to mere density of population. Although it is true that the misery caused by improvident increase of numbers, is not due to any *inevitable insufficiency* of food; yet it is largely aggravated by the necessarily high price of food in crowded places, where, on account of the density of population, and probably also on account of their being employed in manufactures, the food has to be imported from long distances. In a thinly populated food-producing country, all poverty must be greatly alleviated by the cheapness of food; and in a densely populated manufacturing country it is proportionally aggravated.

Moreover, mere crowding, irrespectively of the quantity of food, tends to much moral and physical misery, and aggravates the suffering in many ways. But we are not, at present, concerned with the moral and physical consequences of increasing population; excepting so far as they affect the production and distribution of wealth.

Existing poverty not principally due to any natural or artificial obstacle to the production of sufficient food.

The foregoing considerations do not contradict the previous conclusion that the existing poverty is not principally due to any natural or artificial obstacle to the production of sufficient food, but to the improvidence of individual persons; and one of the commonest forms of improvidence, carrying much suffering to the innocent with it, is the bringing human beings into the world with-

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out the means of providing for their physical and moral health.

The name of Malthus is so identified with the question of the relation of increase of population to sustenance, that we may appropriately notice his theory. He maintained that population tends to increase in a geometrical ratio, and food in an arithmetical ratio; and that, as population must necessarily be kept down to the supply of food, it is so kept down by moral restraint, vice, and misery; the two last operating by disease and death, and having had the largest share of the restrictive operation hitherto.

Explanation of Malthus' theory.

The theory of arithmetical and geometrical progression of food and population respectively, depends upon a restriction of the quantity of culturable land which is distant; and it would be just as true to say that until the whole earth is cultivated, the population and food *tend* to increase in the same ratio. But Malthus seems rather to prejudice his practical argument by this theory. His practical argument seems to be this; that, as a matter of fact, the births amongst large classes of mankind are in number beyond the means *available to them* of healthy existence; and this tendency to increase beyond the available means of existence, is met by early death consequent on the disease and misery attending poverty. This is indisputable; and the inference that the only remedy for this disease and misery is industry and prudence which will store the needful means and not incur

the liability to bring up children before the means are secured, is equally indisputable. But the attribution of the existing misery to the natural difficulty in procuring food for so large a population, is fallacious. On the contrary, as stated above, it is probable that our present large population does actually produce proportionally more food and other things exchangeable for food from foreign countries, than it did when the number was smaller.

Of course, if people be classed by their occupations, there are classes whose extreme poverty is due to their large number; because that number creates great competition for the particular occupations. For poverty is both cause and effect of inability to change occupation, place and other circumstances. No increase of general wealth can of itself prevent such poverty. Social system may aggravate or alleviate the tendencies which produce such crowding and such competition; but the ordinary source is improvidence; and the only complete remedy for the consequent poverty must be moral.

CHAPTER XXX.

DISTRIBUTION OF WEALTH.

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IT has been shown in Chap. VII. how wealth is accumulated. It remains to consider what laws govern the distribution of it.

The class which lives on wages.

Land (as representing all natural agents), capital and labour, are the means of wealth. In modern intertrading communities there is a large class who, having no land and no capital, can live only by wages, *i.e.* by the sale of their labour. It is important to remember that this class includes all whose sole support is wages, and who may be some of the highest state officers as well as the humblest day labourer.

The class which lives on profits of capital.

There is a second class, that which is ordinarily intended by the name 'capitalist,' who possessing previously accumulated capital, employ labour, reproducing the capital with profit and living on the profits.

The class which lives on interest of capital.

There is a third class who possessing previously accumulated capital, live on the interest of it, *i.e.* lend it to others, who employ labour with it; and live on the price paid for the loan. These, for most purposes of the

present inquiry regarding distribution, may be classed with the capitalists proper.

The class which lives on rent of land.

Moreover, as capital cannot dispense with the use of land, the exclusive possession of land commands a price or rent of so much capital for its use, on which rent the landowners live. Consequently the land-owners may be identified with the third class, and ordinarily classed with the second

There is another large class of dependents, principally women and children, who may be classed with the capitalists and labourers respectively on whom they depend.

There is, besides, a large pauper class, those who are dependent upon the community generally. It is a class of great social significance; but one which does not affect the principal problems of distribution of wealth.

Distinction of capitalists and labourers.

We may therefore regard each community as consisting of capitalists (direct or indirect employers of labour), and labourers (receivers of wages). A man may, of course, be both capitalist and labourer; but the principal questions of distribution depend upon the separate claims of capital and labour and are best treated by assuming the separation of the two classes which largely exists in fact.

Misconceptions of fundamental laws of property.

The very fundamental laws of property in capital, which underlie all the problems of distribution of wealth, are so imperfectly understood; and so questioned by the working classes in the present day; that we must first

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consider these, in order to give a thoroughly practical bearing to the propositions touching the distribution of wealth.

Mere violence excepted, everyone, of necessity, lives either by the direct produce of his own labour, or by wages for his own labour, or by the produce of others' labour to which he has acquired a right.

Only the extinction of property can extinguish the capitalist class.

Nothing but the extinction of private property can prevent the growth of a capitalist class. Unless there be special laws which appropriate to the State (for distribution by the State) the produce of each man's labour; some inevitably accumulate their produce. This accumulated produce by its exchangeability for the labour, or produce of labour, of others, is, virtually, a command of the labour of others. The possessor of it is a capitalist. Special laws may, of course, limit the accumulation of private property instead of extinguishing it; but nothing but extinction of private property can extinguish the capitalist class. All men are not equally strong, industrious and judicious; and all do not incur equal liabilities such as the support of wife and children; so that nothing but special laws appropriating and distributing the surplus produce of men's labour, can prevent some from accumulating that surplus, and accumulating it by means of exchange, in the mode which will most readily command the labour of others. It is essential to apprehend this at the outset, that a capitalist class, a class which has acquired a right to the produce

of others' labour, and, consequently, the power to live without the use of their own labour, cannot be excluded on any other condition than that of pure communism; a condition in which no one has any separate property in the produce of his own labour, which belongs to the State, to be distributed, by the State, according to the needs of the community.

The extinction of wages an impossibility.

The extinction of wages is an impossibility. Not only must there be always much necessary unreproductive work, which must be paid for by wages; but even the extinction of wages for reproductive work, is impossible. It is evident that, in the supposed case of pure communism, all live upon wages; because the man who receives a share of produce not measured by his own productive power, or his own contribution of capital, does, in fact, live on wages. When accumulation of private property is permitted, the prohibition of wages for reproductive work, would mean that a man may buy the produce of labour but not the labour itself; a distinction evidently impossible to maintain; or it might mean that the employer of labour should be compelled to pay for it in proportion to the value of the things produced, *i.e.* should give the labourer a share in both profits and risk. But as the labourer would often refuse to take a share in the risk; such a law would in many cases be evaded; and wages would be substituted by common consent of labourer and capitalist.

We repeat the previous conclusion that the extinc-

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tion of the class of capitalist is impossible under any other condition than pure communism.

Pure communism economically impracticable.

Pure communism would extinguish every motive to individual productive industry excepting duty, the pleasure of work, and external compulsion. Even the pleasure of work would be in great part destroyed by the necessity that the kind of work should be assigned by the State instead of being chosen by the individual. What would be the diminution of productive energy, when all hope of individual profit is gone, and the motives to labour are nearly restricted to a sense of duty and to compulsion, it is difficult to calculate. But we cannot doubt that it would be enormous, and alone sufficient to make pure communism in any large community, whilst human nature remains as at present, an economical impossibility. With its other social consequences, this treatise is not immediately concerned; but it is really as impracticable socially as economically.

Exceptional character of property in land.

There is one kind of property which has in some degree an exceptional character and respecting which a larger reserved right of interference with the absolutely free disposal of it than in the case of most other things,[1] is always just and needful. We speak of private property in land. Private property in land, must always, both in principle and by necessity, differ from property in anything which can be produced by labour. It differs

[1] We say 'most other things.' An absolutely free disposal of such things as gunpowder or strong poisons, for instance, is not permitted.

in principle, because the assumed right of a man to hold and to transfer to others, what is produced by his own labour, is evidently the principle on which private property in things produced by labour is founded. The land in its original state, is not the produce of labour. The property in land also differs of necessity; because the whole community must live by the use of the land; and private property in it can never be so absolute as to allow of its withdrawal, except to a limited extent, from the general service of the community. Thus, the right to resume it for public purposes, is always reserved and exercised, when needful, by the State. But some kind of property in land, some exclusive appropriation of it, is inevitable, in order to give inducement to cultivate it. Even if the State be the owner, the *use* of the land always is, and must be, exclusively appropriated, in order to sufficient motive for maintaining or improving the productive power of the land. So that, whilst the distinctive character of property in land, does beget some important social and economical theories; it does not present any exceptions to the general laws of distribution now treated.

Possible distribution of decreasing or increasing wealth.

It was shown in Chap. XII. that the immediate destination of surplus capital, must be as wages for labour. So far as the surplus is employed reproductively, the future surplus must be greater; so far as it is employed unreproductively, the future surplus will be less. Moreover, whilst in an isolated country or in the

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civilised world as a whole, reproductive expenditure, by making a larger wages fund, tends to enrich both capitalist and labourer; and actually does so excepting so far as the tendency is hindered by increase of population; the relative loss attending unreproductive expenditure, might, conceivably, by simply diminishing the wages fund, fall entirely on the labourers, until wages are reduced to the lowest endurable limit. This tendency, though conceivable, and perhaps realised in some countries, at some times, under the combined influences of insecurity of profits of capital and serfdom, does not seem to be supported by any present experience where labour is free and the profits of capital secure. The tendency, under free conditions, would doubtlessly be counteracted by the decrease of capital increasing its value, and thereby increasing the desire of capitalists to employ it profitably. It would also be counteracted by the moral and economic effects of constantly falling wages.

On the other hand, it is hardly conceivable that the gain attending an increased reproductive expenditure, should accrue exclusively to the labourers. This would imply increasing production without increasing profit to capital; in which case, the capitalists would have no adequate motive for employing an increasing share of the produce reproductively, instead of employing it unreproductively in luxuries for themselves.

Practically, the distribution of increase or decrease of

surplus between capitalists and labourers is in such various proportions according to varying circumstances; that it is impossible to establish any normal condition of distribution. All that can be done is to show the circumstances which advantage or disadvantage the one class or the other.

The relative advantages of capital and labour in the distribution of the produce as profits and wages.

Capital seems to have at present, on the whole, one constant advantage over labour, in that it is more easily removable from one place or occupation to another. The capitalist is not inseparable from his capital, as the labourer is from his labour; so that there is, often, a personal unwillingness to change of place or occupation in the one case, which does not occur in the other. In many cases, however, in which capital has been largely converted into fixed capital suited only for some special occupation; the labourers are advantaged by the inability of the capitalist to change the occupation of his capital without great loss. Thus it appears that the use of machinery, tends to place labourers and capitalists more on an equality as respects ability to change place and occupation. It seems possible that, as education removes the merely ignorant unwillingness to personal change of place; whilst the practical difficulties become less and less; the ability to change place, and even occupation, may, eventually, be more in favour of labour than capital.

In one respect the use of machinery tends to place labourers more on an equality with capitalists.

The limits to

The distribution of the produce between capital and labour as profits to the one and wages to the other, is

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the fluctuation of wages.

simply a question of the price of labour, a thing determined by the haggling of the market like any other price. But there are certain limits which cannot be overpassed for long. The capitalist will not, for long, purchase labour which produces him no profit. There is some standard of wages in each class below which wages cannot remain for long, without driving away the labour. But, within these extremes, the wages must fluctuate like the price of anything else. Of course society can interfere by law with fluctuation of wages. Society might, conceivably, regulate all prices, wages and profits, just as, conceivably, it might establish pure communism. But, practically, such laws would be found, in many cases, to be so opposed to the wishes of both buyers and sellers of labour and of other things, that they would be evaded by common consent. So far as such laws might be effective, they could hardly fail to diminish the inducement to the capitalist to employ his wealth reproductively, and, by consequence, to diminish the wealth of the community. The practical difficulties would be, of course, enormous, demanding constantly increasing interference by law. For instance, if the law forbids a man to sell his labour below a certain price; it must almost inevitably concern itself with providing work for him at that price. But, in a free state of trade, the price of labour being determined by equation of supply and demand, the capitalist as a purchaser of labour, and the labourer as a seller of it, are, re-

Consequences of regulating wages by law.

spectively, advantaged and disadvantaged, like the buyers and sellers of other things, by the relative urgency of their needs to buy and sell. But it must be admitted that, on the whole, the labourer is more dependent on the capitalist than the capitalist on the labourer; because, excepting so far as the labourer has become a capitalist by saving some capital, he cannot live without selling his labour. Whereas the capitalist can live on his accumulated capital for some time; and has his own possible labour in reserve.

It may be asked, 'Is then labour helplessly dependent upon capital?' It is well to consider every question in its simplest elements; and, therefore, it must be declared that the labourer unpossessed of any capital whatever, is in a most helpless dependence on the capitalist. But if the labourer has some small capital to support him for a short time; he can do much to keep up the value of labour; especially by transferring it to the markets where it is most in request.

Education tends to raise wages.

As pointed out above, the inseparability of the labourer from his labour, often causes great personal unwillingness to change of place or occupation. Education (in the widest sense) tends to remove this obstacle. It is capable of making change of place or of occupation, attractive instead of irksome. Education, also, tends in another manner to raise wages. It raises the minimum condition which seems endurable; and so raises the minimum rate of wages; and so makes the tendency to

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seek higher wages by change of place or of occupation, effective at a higher point. It also facilitates common action by the members of a given class.

Special advantage of a high minimum rate of wages.

A high minimum standard of comfort, which is equivalent to a high minimum rate of wages, is of great advantage in providing for the endurance of some sudden inevitable diminution of demand for labour, such as may be caused by war or failure of crops. When the American war stopped the supply of raw cotton and the demand for factory labour in Lancashire, the previous comparatively high standard of wages and living of those labourers, left them generally with some property, if only household furniture, by sale of which they could sustain themselves for a time, whilst efforts for their relief were in process of organisation. In short, the value is obvious, of the difference between the condition from which any immediate fall is only to comparative poverty, and that from which there is only one step downward to pauperism or starvation.

The means of securing a larger share of produce to the labourer.

It is evident that all means of increasing the share of the produce which accrues to the labourer, resolve themselves into means of making labour more valuable or of giving the labourer a share of the profits of capital. Labour can only become more valuable by being more effective or relatively more scarce. The labourer can make his labour more effective by greater skill or industry. He can make his labour relatively more scarce by any accumulation of capital which enables him to bargain

with the capitalist or employer on more equal terms; and by all intelligence which enables him to change the direction or place of his labour, if need be. He can only obtain a share of the profits of capital, by becoming in some degree a capitalist himself.

Association of labour and capital in the same persons.

The labourers or association of labourers, who have sufficient capital to support themselves and to supply necessary raw material and mechanical aids during the process of production, may be independent of wages. This is the ideal condition of the productive labourer, because it assures to him (what nevertheless he may have when in receipt of wages) the utmost advantage of his own labour. In some kinds of work it is possible for each person possessed of ordinary health and strength and well instructed. In almost all work it is possible for associations of a few well instructed prudent men. It is practically impossible for a whole class for reasons which will be given in the next chapter in connection with 'Co-operation.' But there is no shorter and easier road than the industry, thrift and intelligence of the labourers, whereby to attain this condition. Of course the higher the rate of wages, the easier it is to save capital out of wages; and other circumstances than the prudence and industry of the labourers may raise the value of produce and consequently the value of labour and the rate of wages. But, in order to get more than wages, in order to obtain a share in the capitalist's profits, the labourer must supply some of the capital as well as the labour.

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Simple as this is, it is not recognised by millions of working men in Europe.

Character of wages which fluctuate according to profits.

The foregoing is not really inconsistent with a mode of paying wages, which may, in one sense, be described as giving a share of capitalist's profits to the labourer; viz. payment of a rate of wages which varies according to the profits of the employers. It is not the less 'wages' although it varies in amount according to the profitableness of the work; just as payment by piece-work is not the less wages although it varies in amount according to the efficiency of the labour. Both are strictly 'wages' and not 'profits' when a matter of free bargain; because both are really determined by the equation of supply and demand of labour which regulates wages.

In speaking above of independence of wages as the ideal condition of the productive labourer, we intend no discredit to working for wages. The circumstances which give the ideal character to the condition, are the freedom which belongs to it, and the fact that the men, or association of men, so working, are assured of the fullest advantage of their own labour. But the worker for wages, by independence of risk, and a consequent freedom from care which is of high value to some minds, may have, as truly, the full advantage of his labour. Under all circumstances, there will be many cases in which wages are more suitable, and equally honourable, as compared with a share in risk and profit.

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Explanation of certain misapprehensions of the relations of labourers and capitalists.

It is, of course, only the *productive* labourer who can possibly be independent of wages. But there is another reason for specially considering the circumstances of the productive labourers. It is these only whose relation to the capitalist class involves any practical difficulties. The Lord Chancellor, a domestic servant, a clerk, a soldier and an artisan, are alike labourers paid by wages. But it is only the class of productive labourers, to which the last belongs, which supposes itself the poorer by the wealth of the capitalist. Other classes may envy the wealthy; but they do not suppose themselves the poorer for others' wealth. There is no real difference in the case of the productive labourer. The *seeming* difference is that, because the capitalist appropriates the greater part of what the labourer produces, it *seems* as if the labourer would have it if the capitalist did not. But this is a delusive seeming. The produce is the result of both labour and capital. The labourer who has not saved any capital, could produce nothing if left to himself. He has no means of living except by selling his labour to those who have capital.

It is the command of large capital which enables the capitalists to make large profits; and if they had not made the profits, the labourers without a similar command of capital, could not have made them for themselves. The productive labourer is no more the poorer by the capitalist's wealth than a domestic servant is poorer by his employer's wealth. Both the one and the other

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would, of course, be richer, if their employers would give them larger wages for their labour. The servant, like the artisan, may think that he ought to receive more; but he does not think that his employer is rich because he, the servant, is poor. The artisan often does think so; but in substantial fact, he has no more ground for the opinion than the servant. In one sense it is indisputable in both cases, that if wages were higher, the employers, *cæteris paribus*, would not be quite so rich. But, in the main, the wealth of the employers is not because wages are low, but because they, or others whom they represent, accumulated capital. Prudence, industry, enterprise and thrift, even now enable the individual labourer to obtain higher wages and to accumulate capital; and in proportion as these virtues exist in a whole class, will that whole class obtain higher wages, acquire capital and the profits of capital; and so the wealth of the community will be more equally distributed. But there is no shorter and easier road to this desired end, without extinction of private property. This subject will be further treated in the chapter on 'Co-operation and Combination.'

The economic advantage of the existence of an exceptionally wealthy class.

Before concluding the subject of distribution of wealth, it may be well to note how far the notion is true, that the existence of an exceptionally wealthy class benefits (in an economical sense) the whole community. At first sight, it seems absurd to suppose that a community, as a whole, can be wealthier by a few appropriating a

large portion of the produce, living in idleness, so far as production is concerned, and spending a large part in unreproductive ways. It seems to involve the absurdity of a community being wealthier by diminishing the numbers employed in production.

We may regard the ideally perfect economic condition of society, as that in which everyone has a large share of surplus capital, so that all severally and collectively are provided for all contingencies. This in fact supposes universal industry and prudence. The opposite extreme is a condition in which there is scarcely any surplus capital at all, and there is no spare capital for conversion into fixed capital or other means of increasing the efficiency of labour; a condition in which any serious deficiency of a season's produce, or other hindrance to ordinary production, causes famine. In regarding these two cases, it becomes clear that it is more advantageous to all that there should be a considerable surplus in the hands of a few, than that there should be no surplus at all. In other words, the existence of an exceptionally wealthy class represents, either in fact or in effect, the greater prudence of a part of the community; and so long as improvidence prevails so largely as is usual hitherto, that greater prudence of a few, is an economic advantage to all.

Summary of principal propositions.

The principal propositions in this chapter are

1. Wealth as fast as it is produced is distributed between capitalists (employers of labour directly or indirectly) and labourers (receivers of wages) as pro-

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fits or interest to the former and as wages to the latter.[1]

2. The share of the produce obtained by labour is the price of the labour determined by equation of supply and demand for each kind of labour.
3. Capital seems to have on the whole at present, a constant advantage over labour in its greater readiness to change place and occupation.
4. The use of machinery tends to diminish the advantage stated in the foregoing proposition; and might, possibly, eventually transfer the advantage to labour.
5. Nothing but the extinction of private property can prevent the existence of the separate classes of capitalists and receivers of wages.
6. Interference by means of law to regulate prices, wages and profits, would diminish the wealth of the country on the whole.
7. Education, in the largest sense, is the greatest means for improving the condition of the labourers; because there are no assuredly effective means to obtain for them a larger share of produce, excepting the acquisition of capital by the personal industry, thrift, prudence and intelligence of the labourer.

[1] Many persons belong to both classes; but the question of distribution can only be treated by separation of the claims of capital and labour.

CHAPTER XXXI.

COMPETITION, COMBINATION AND CO-OPERATION.

THREE words have been placed at the head of this chapter, which are in frequent use in connection with questions of political economy; and which are severally ambiguous, because they have acquired certain technical limitations, which, nevertheless, do not exclude their use in a more general sense.

Meaning of 'Competition.'

Competition is often used as a technical term to denote only the competition of buyers to obtain part of a limited supply; or of sellers to secure a part of a limited demand. It also denotes all kinds of competition which affect the production and distribution as well as the exchange of wealth.

The effects of competition.

Competition is a motive as desirable, in measure, as it is inevitable. If there were no competition, the greatest stimulus to invention and improvement, especially the invention of means of making labour more effective, would be withdrawn. But it is a selfish motive; and, consequently, is liable to pernicious development. The true limits of it are moral; though the economical consequences often give warnings which coincide, in

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direction, with the moral judgment. The competition of producers to obtain custom, by offering goods at low prices, often leads to an inferiority of produce, which, being really more costly to the consumer than better goods at higher prices, is wasteful. Ignorant competition for the profits of capital, as eminently exhibited in connection with joint stock operations, sometimes causes wide-spread waste and ruin.

Unlimited competition.

The study of political economy has done so much to remove restrictions on trade, which were an obstacle to free competition, that it is often supposed that unlimited competition is a logical consequence of the principle of free trade. But it is only the unlimited *permission* of competition, as distinguished from external authoritative interference with it, which is a necessary consequence of the principle. And even this consequence is restricted by some social considerations which outweigh the economic principle; as, for instance, the consideration of the defencelessness of childhood, which underlies the laws restricting the employment of children's labour.

Competition is only a part of that due general regard to self-interest, without which society would lose its organic force. But there seems to be no more reason to regard unlimited competition as the means of most effective production, than pure selfishness (of which it is the economic expression) as the means of most effective social action of any other kind. 'Competition' needs to

be limited by that regard to others, which is implied in the principle of 'Co-operation.'

Combination.

'Combination' is commonly used to denote only united action of one class to maintain its class interests in opposition to those of another class. It takes various shapes, all tending in their immediate effects to diminish production. Such is combination to restrict the numbers admitted to the practice of any trade or to restrict the conditions on which the members of the trade may work (so to restrict the supply of labour and to keep up wages). Such restrictions may, in some circumstances and in some degree, be beneficial; but it is obvious that they must tend, in their immediate effect, to limit production.

The restrictions imposed by combination.

Such restrictions, however, are not peculiar to ordinary trades unions. There are analogous arrangements, for instance, in the legal and medical professions. So far as they secure better skill and adequate remuneration, they are beneficial. So far as they secure inferior workmen from the competition of better men; and so far as they compel payment for unnecessary work, as seems to be sometimes the case, they must be injurious.

Strikes.

Combinations of workmen to maintain or increase the rate of wages, often take the well-known shape of 'Strikes.' This prevalent form of combination demands special notice. The corresponding temporary refusals by the employers or capitalists to employ labour, with the purpose of keeping down the rate of wages, and

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known by the name of 'Lock-outs,' are analogous to the 'Strikes.'

Putting aside the violence and coercion which sometimes attend these strikes, and which, like other forms of interference with personal freedom in trade, are, by fundamental hypothesis, excluded from the general propositions of political economy; strikes are a form of bargaining, the haggling in the market, by which the price due to the true relation of supply and intensity of demand, is determined. They are tentative refusals to sell labour at the price offered.

It is hopeless to expect capitalists to work without profit. Therefore, when the reduction of wages, or the low rate of wages, which is the cause of a strike, is due to very low profits; it is evident that a strike can hardly be effectual for its purpose.

On the other hand, if the profits of the capitalist are really so great as to give abundant means of increasing wages; and if the wages are really so low that a moderate increase would not be likely to attract additional and therefore competitive labourers to the particular business; a combination amongst the labourers would, probably, be successful in securing larger wages.

It is sometimes said that strikes never obtain a rise of wages which would not have soon occurred without the strike. It seems impossible to believe this. As competition of workmen tends to lower wages; so the withdrawal of competition by the combination of the work-

men, must tend to higher wages. It is, of course, true that wages cannot be forced by strikes, or by any other means, beyond what the employers are really willing, in the last resort, to give. But, unless wages have already reached that point; strikes must tend, though not of necessity effectively, to raise wages.

The relative claims of capital and labour.

Some of the greatest difficulties in connection with strikes and analogous struggles between capital and labour, arise from misconception of the relative claims of the workman and the capitalist, rather than from misapprehension of the circumstances of any particular trade.

Profit is the value of produce in excess of the value of the wages and rent paid and capital expended in production. It is the remuneration of the capitalist who takes the risk of the trade; and who supplies much needful agency which the labourers do not supply. The labourer ordinarily takes no share in risk, *i.e.* no share in the responsibility for the supply of capital. A labourer has no more necessary right to higher wages, simply because the capitalist makes larger profits; than a judge on the bench or an officer of the army has a right to higher wages if the wealth of the people who employ him be largely increased. It may be right to give it; and the wages of many classes are so low, that it is a moral duty of their employers to improve their condition if practicable. But increasing profit ought to be no more *necessarily* regarded by the capitalist as a reason

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for higher wages, than decreasing profit ought to be necessarily regarded by the labourer as a reason for lower wages.

There is nothing, in the foregoing remarks, inconsistent with the advantageous adoption of a rate of wages which fluctuates according to the rate of profit of the business; if capitalist and workmen can agree thereon. It was noted, in the preceding chapter, that such payment may be truly regarded as mere wages; just as payment by piece-work is mere wages. Or, if anyone insist on regarding it as a share of profits; there is still no inconsistency; because the workmen who make a specific agreement that when the return of capital is diminished, they will diminish their demands on the capitalist, do indirectly help to supply the needful capital; and take a certain share in the capitalist's risk; and, so doing, they are entitled to a due part of the profits in addition to the wages of their labour.

The application of the foregoing considerations.

The above considerations afford no absolute guidance as to the effective operation of strikes. They show, however, some of the conditions of reasonable demands and hopes. They show that, in a failing trade, such, for instance, as some hand-work struggling for existence against machine-made work of the same kind; all combination to resist the fall of wages must be hopeless. They equally show to the capitalist that, in a trade which, by increasing profits, induces an increasing demand for the services of the workmen, a rise of wages is

inevitable. Further they indicate considerations which, rightly understood, would help to correct the misconception of the true relations of the capitalist and workman, which, in so many cases, embitters the negotiations between them, and hinders the co-operation which would be for their mutual advantage.

On this subject of strikes, it seems desirable to admit the introduction of social and moral as well as economic considerations.

Further considerations touching strikes and lock-outs.

Strikes and lock-outs are, as stated above, analogous to the bargaining of the market. But they often become, in fact, much more. They become struggles in which men, confessedly, aim at more than the mere settlement of a present bargain; struggles which beget much more hostility, much bitterer feeling, than the ordinary rivalry of the market.

Strikes a kind of war.

'Strikes' and 'Lock-outs' are, in fact, a kind of war. But we may reasonably assume that it is a war in which it is scarcely possible, and, if possible, certainly not desirable, that it should end in the total subjugation of either party. Every unprejudiced man must desire a great improvement in the condition of the greater part of the working classes; and must equally desire that the remuneration of capital shall be secure; if for no other reason, because all classes, and the workmen most of all, would suffer by the diminished production which would attend any insecurity in the returns to capital. It is a war, therefore which must end in compromise; and it

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would be the wisdom of both parties to seek to establish the compromise as soon as possible.

The dominant notions of the two parties.

The ideas which possess the two parties, vary on different occasions and in different industries.

The principal truths which underlie the action of the workmen, are,—firstly the moral conviction that they ought not to be content to remain in their present condition; and that they have a perfect right to combine to improve their condition;—and secondly the economic conviction that competition of workmen tends to lower wages; and that, consequently, the withdrawal of competition by union, tends to higher wages; and that union in demand for higher wages and in a tentative refusal of less, must be more effective than casual and individual demand.

The principal truth which underlies the opposing measures of employers or capitalists, is that the intended action of the workmen is often such as, if submitted to without resistance, would make the profits of capital intolerably uncertain. If the demand for a certain rise of wages were final on acceptance, like the offer to sell an ordinary commodity for a given sum; it would be a very different case from what often happens. The one month's labour or whatever be the short time for which the temporary agreement is binding, is often comparatively useless to the capitalist; unless he be assured of a similar supply for a longer period. It is only a bargain for a part of an indispensable quantity of a certain commodity.

If the only effect of the capitalist or employer conceding an increased price for a part of the indispensable labour, be to ensure another demand at a higher rate soon after, and, probably, at the time when he is most dependent on the labour; he reasonably feels that resistance is required on his part.

The practical error of both parties, consists in too blindly regarding their own immediate interests, without regard to the indisputable consideration, that as they cannot get on without each other's aid, their interests are mutual.

The workmen sometimes push their demands, until they virtually claim to have the profits of capital, without providing any part or taking any of the risks of capital. Sometimes they refuse to make any agreement for a period sufficiently long to give a reasonably sure basis to the employer's calculations.

On the other hand, the principal error of the employers or capitalists, seem to be their non-recognition of the principle in which a remedy for the struggle between capital and labour, is to be sought.

The remedy.

Resistance to combination promises no permanent solution. It may simplify, but it may, at the same time, intensify the dispute; and success, by the nature of the case, can be only temporary. The remedy, therefore, seems to be, not to resist combination, but to develop it; for combination of all is co-operation of all. A wider union might come to terms which would give the work-

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men a due share of increased value of produce, without a struggle for it at every stage. But, to secure this, the workmen must be ready when profits fall, to accept diminished wages without complaint.

The several kinds of co-operation.

Thus we seem fitly to arrive at 'Co-operation' as the concluding principle for consideration. We have already, in this chapter, in some degree, anticipated the definition of it. It has several meanings.

1. It has the general meaning of harmonious adaptation of different kinds of work to a common purpose; as one speaks, in a general sense, of the co-operation of capital and labour or of the merchant and producer.

2. It sometimes denotes a special co-operation of consumers to deal directly with the wholesale merchants, and, by providing their own retail agency, to exclude the operation of so much of the motives of the retail dealer as are contrary to the interest of consumers. This is the system of co-operative stores, with which most persons are now familiar.

3. It is sometimes used to denote a special kind of co-operation between capital and labour, by which the remuneration of the labour, fluctuates in proportion to the value of the produce.

4. It is used to denote the co-operation of workmen as small capitalists working by joint stock, whereby they may become independent of the large capitalist; and may share amongst themselves the profits of the capital employed, in addition to the wages of their labour.

These two last are the most significant kinds of co-operation; because, as already shown in this chapter and in the previous chapter on 'Distribution,' they are the modes in which the solution of many difficulties and the beneficial development of industry, may be most hopefully sought.

Remuneration of labour by wages which fluctuate according to profits, is not always practicable. A house builder, who looks for the profit on his capital by selling or letting the house at some time after its completion, could not make an agreement with his workmen on such a system. Analogous difficulties would occur in many cases. But the system, whenever practicable, tends to make the interest of the employer and of the workman identical; and to give to each workman an interest in the industry and fidelity of his fellows. These motives, as tending to avoid waste and to dispense with costly supervision, are of great economic value; whilst the moral and social advantage of everything which shows the community of the interests of capital and labour, must be immense.

The co-operation of the workmen as small capitalists, so to secure to themselves the profits of capital, is the most significant means of beneficial organisation of industry. It is a means which has already been developed successfully to an extent which, in its experimental character, is far from inconsiderable. Wherever begun effectively, it implies a degree of previous prudence

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to save capital, and of educated intelligence to organise and administer joint stock operations, which alone are sufficient to ensure continued successful extension. There are, however, obstacles and limits to such co-operative association of workmen, which need to be known.

General considerations touching union of workmen.

All co-operative association of workmen with mutual and equal liability, is limited, in extent, by the indolence and improvidence which is sure to be found amongst any large class. A few who have learned to trust each other can work together with equal liability and equal claims. But amongst any very large number, association on exactly equal terms, is impracticable, because of the unequal efficiency and value of the labour of the several men. The idea entertained by some enthusiasts that a whole nation might work in partnership, *i.e.* the idea of communism, is an impracticable dream. The partnership of a large class on exactly equal terms, is similarly impracticable. So far as the contribution of capital and the division of profits calculated separately from wages, is concerned; there is no limit to the number who can work in partnership. The quantity of capital contributed by each is an ascertainable fact; and the proportionate share of profits is an arithmetical calculation. But each workman's labour, as a contribution to the common stock, is not a constant quantity nor so easily measurable; and any number of men so large as to include every degree of efficiency which the various degrees of strength, skill or industry afford, will not, for long, consent to work

together on the condition of all sharing equally in the produce.

A consequence of the foregoing consideration, is that the existing 'Unions' or associations of workmen are much too large for purposes of co-operative work. The purposes of these unions as respects mutual provident assurance in case of sickness, &c., demand association of the largest numbers; and for such purposes the unions are wholly beneficial. But some of their purposes are only attainable by means of restrictive rules which benefit the inferior workmen at the cost of the superior. Such, for instance, are rules restricting the time or quantity of work to be given daily. It is a thing to be regretted that any man should be precluded from the full use of his skill or industry; more especially if the means of restriction hinder the co-operation which would unite the functions and advantages of capitalist and labourer in the same person. Such restrictions, freely self-imposed, may, for a time, be the best course immediately practicable; but any means for maintaining a better remuneration or easier conditions to the workmen, must be essentially defective, if they consist in restriction of industry and production, rather than in modes of intelligent thrift whereby to obtain a share of capital and of its profits.

Conclusion.

In conclusion, it may be said that political economy is, indeed, in one aspect, the science of co-operative production, as distinguished from all merely forceful means

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of acquisition. Whilst competition is a necessary element in industry; but a selfish one needing control, like the regard for self-interest which, in measure, is essential to social life; co-operation seems good in every practicable form and attainable degree.

We have endeavoured to exhibit the elementary facts and tendencies and the principal phenomena which form the subject of the science of political economy; believing that, whilst physical science is doing much to make the work of production more fruitful; political economy shows how to make it more widely beneficial. But, after all, some of the greatest difficulties in the practical apprehension and application of the science, are found to be moral difficulties made by selfishness. Therefore, in 'Co-operation' which regards the interests of all, seems to lie the best hope of a counterveiling motive and a ruling principle.

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